82-1659

Office-Supreme Court, U.S.
FILED
MAR 28 1983
ALEXANDER L. STEVAS,
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NO.

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

FRED J. ROBINSON, et al.,

Petitioners

v.

CUMBERLAND CAPITAL CORP.,
et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

APPENDIX

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IN THE SUPREME COURT OF TENNESSEE
AT KNOXVILLE

FRED J. ROBINSON, ET AL.,	)	
	)	
Petitioners,	)	
	)	
vs.	)	Blount Law
	)	
CUMBERLAND CAPITAL CORPORATION, ET AL.,	)	
	)	
Respondents.	)	

O R D E R

Petitioners seek review in this Court by petition for certiorari from an interlocutory order of the Court of Appeals. The majority of that Court held that a circuit court lacks jursidiction to entertain a class action under Rule 23 of the Tennessee Rules of Civil Procedure.

This Court does not agree with the conclusion of the majority of the Court of

Appeals on this issue. Accordingly the petition for certiorari is granted, the order of the Court of Appeals based upon the majority opinion is set aside, and the cause is remanded to the Court of Appeals for determination of the issues pretermitted by it. In particular, the Court of Appeals should determine whether this cause can or should properly be permitted to proceed as a class action in light of the decision of this Court in the case of Cumberland Capital Corporation v. Patty, released on August 22, 1977, dealing with the constitutional question raised in the instant case.

All costs will be determined by the Court of Appeals.

Enter this 19th day of September, 1977.

PER CURIAM

IN THE COURT OF APPEALS OF TENNESSEE

EASTERN SECTION

FRED J. ROBINSON, ET AL	)	
	)	
-vs-	)	BLOUNT LAW
	)	
CUMBERLAND CAPITAL CORPORATION, ET AL	)	

O R D E R

This Court for the second time has for consideration defendants' petition for certiorari and supersedeas asking to vacate the circuit judge's order permitting these suits to proceed as a class action.

In the light of the decision of the Supreme Court in Cumberland Capital Corporation v. Patty filed on August 22, 1977, and as we interpret and construe Rule 23, et seq. of Tennessee Rules of Civil Procedure, these suits can not properly be

maintained as a class action. Undoubtedly, the thousands of claims based on individual loan contracts of the thousands of plaintiffs against the hundreds of defendants present questions of law and fact not common to all the parties and will present questions affecting individual plaintiffs and defendants in different ways.

Therefore, the orders of the Circuit Court of Blount County entered November 16, 1976 and January 5, 1977, directing that these actions proceed as a class action are hereby superseded and vacated.

The cause is remanded to the Circuit Court of Blount County for further proceedings not inconsistent with this order.

This 6th day of October, 1977.

/s/ James W. Parrott
Judge

/s/ Matherne
Judge

/s/ Nearn
Judge

IN THE SUPREME COURT OF TENNESSEE
AT
KNOXVILLE

IN RE: PETITION OF SMOKY MOUNTAIN CONSTRUCTION COMPANY, ET AL.

O R D E R

The Motion for Advanced Hearing filed in the captioned matter is denied. Insofar as the petition in this matter purports to be an original action instituted in this Court, it is dismissed. Insofar as the petition represents an application to intervene in the case of Cumberland Capital Corporation v. Patty, the Court is of the opinion that the application is not timely and it is denied, without prejudice, however, to the right of any of the petitioners to present and rely

upon the arguments and contentions contained in the petition in the regular course of appellate review of any of the cases referred to in the petition.

Costs incident to the petition are assessed to the petitioners

/s/ WILLIAM J. HARBISON
WILLIAM J. HARBISON, JUSTICE

ALL CONCUR

IN THE SUPREME COURT OF TENNESSEE

AT KNOXVILLE

FRED J. ROBINSON,	)	
	)	
PETITIONER	)	
	)	
	)	
VS.	)	BLOUNT LAW
	)	
	)	
CUMBERLAND CAPITAL CORPORATION,	)	
	)	
RESPONDENT	)	

O R D E R

On considering the petition for certiorari and briefs filed in this case and the entire record, the petition of Fred J. Robinson is denied at cost of the petitioner.

PER CURIAM

IN THE CIRCUIT COURT FOR BLOUNT COUNTY,
TENNESSEE,
AT MARYVILLE

FRED J. ROBINSON, ET AL	)	
	)	
VS.	)	NO. 1429
	)	
CUMBERLAND CAPITAL CORPORATION, ET AL	)	

MEMORANDUM AND PRETRIAL ORDER

This matter came on for hearing on October 12, 1980, on a pretrial conference pursuant to TRCP 16. Counsel for the parties appeared and discussed the issues and theories of the case.

This is an action by five sets of plaintiffs to recover usury charges from five companies operating under the Industrial Loan and Thrift Companies Act.

Additionally, plaintiffs are seeking a declaratory judgment and to proceed as a

class action. This is not a proper case for either declaratory relief or class action.

Plaintiffs also seek exemplary damages for intentional violation of the Act and the State constitution because defendants had knowledge at the time the loan contracts were executed that the transactions were usurous.

Every person is entitled to rely on the constitutionality of a legislative act until such time as the act is declared unconstitutional by the Supreme Court of Tennessee. Cumberland Capital Corp. v. Patty (Petition to Rehear) 556 S.W.2d 517. At the time loans were made to the plaintiffs the Supreme Court had not declared any part of the Act unconstitutional. The Cumberland Capital Corp. v. Patty decision limits the retroactive application to cases where there has not been strict compliance with the

Industrial Loan and Thrift Companies Act.

See p. 542.

IT IS, THEREFORE, ORDERED that:

1. The issues to be litigated on trial are:

(a) Did the defendant in each particular transaction, violate the Industrial Loan and Thrift Act as then written?

If (a) is answered "yes," then

(b) What amount of overcharge was collected by the defendant in that transaction?

(c) Is the particular plaintiff barred from recovery as a matter of law?

(d) Did defendants wilfully violate the statute so as to warrant the imposition of punitive damages?

2. The case will be set for trial on the above issues on February 2, 1981 at 9:00 a.m., at the Blount County, Courthouse at Maryville.

3. The names of all witnesses who will testify at the trial and

copies of all exhibits will be exchanged by counsel at least twenty days prior to the date set for trial.

4. Pretrial briefs or short statements will be filed with the Court at least five days prior to the trial date.

5. This order shall supplement the pleadings and govern the course of the trial unless modified to prevent manifest injustice.

/s/ C. Allen High
C. ALLEN HIGH, CHANCELLOR

IN THE CIRCUIT COURT FOR BLOUNT COUNTY, TENNESSEE
AT MARYVILLE

FRED J. ROBINSON, et al.,

Plaintiff,

VS. NO. 1429

CUMBERLAND CAPITAL CORPORATION, et al.,

Defendants.

ORDER

This cause came on to be heard on February 2, 1981, before the Honorable C. Allen High, Chancellor, holding the Circuit Court for Blount County, Tennessee, by designation. The cause was before the Court for trial upon the Complaint, the Amendments thereto, the Answers filed by the Defendants, and pursuant to the Memorandum and Pretrial

Order entered by the Court on December 29, 1980, and the entire record.

Court having convened, counsel for the Plaintiffs gave oral notice that they wished to take voluntary dismissal without prejudice pursuant to Rule 41 of the Tennessee Rules of Civil Procedure in behalf of the Plaintiffs, Fred J. Robinson, Janet Hatcher (formerly Janet Robinson); Tecora Dowdle, individually and as Administratrix of the estate of Camilla Fortune; James D. Northern; and Charles T. Dawson and wife, Alice E. Dawson, (hereinafter "Plaintiffs"), as to all claims asserted in paragraph XII, section 2, of the Complaint wherein the Plaintiffs sought declaratory relief. Counsel for the Plaintiffs announced that the voluntary dismissal would extend as to all claims for relief with the exception of declaratory

relief as prayed for in said paragraph XII, section 2, against the Defendants Cumberland Capital Corporation, American Credit Company, Home Credit Company of Tennessee, Inc., BFS Finance, Inc., and American Credit Company of Tennessee, Inc., (hereinafter the "Defendants").

Thus, there would remain for disposition the sole claim for declaratory relief asserted by all of the Plaintiffs against all of the Defendants and all claims asserted by Sharon Y. Hannum against Commercial Credit Plan, Inc. In accordance with Rule 41, the notice of dismissal as herein stated is appropriate and will be permitted by the Court with all costs to be taxed against the Plaintiffs.

Thereafter, counsel for the Defendants moved the Court to dismiss with prejudice the

remaining claims of the Plaintiffs for declaratory relief in that the remaining portion of the Complaint as amended failed to state a claim upon which declaratory relief could be granted. Counsel for the Defendants urged that pursuant to TCA §23-1101, et seq., the Plaintiffs had no further rights to be declared as between the parties and that they were seeking an advisory opinion which the Court is not authorized to issue. Further, this Court in its Memorandum and Pretrial Order dated December 29, 1980, had considered the prayer of all Plaintiffs for declaratory judgment and had determined that this was not a proper case for declaratory relief. Accordingly, the motion of the Defendants to dismiss the remaining claims of the Plaintiffs is proper and will be granted.

It is, therefore, ORDERED, ADJUDGED

and DECREED as follows:

1. Upon the oral notice during trial by counsel for the Plaintiffs, all claims asserted by the Plaintiffs with the exception of the claim for declaratory relief asserted generally in paragraph XII, section 2, of the Complaint against the Defendants are dismissed without prejudice, a voluntary dismissal having been taken by the Plaintiffs.

2. The remaining claim for declaratory relief asserted generally in paragraph XII, section 2, of the Complaint in behalf of the Plaintiffs as against the Defendants be and the same is hereby dismissed with prejudice.

3. In accordance with paragraphs 1 and 2 above, all pending claims as between the Plaintiffs and the Defendants are therefore dismissed in their entirety and all

costs incident thereto are taxed against the Plaintiffs for which execution may issue if necessary.

4. The case of Sharon Y. Hannum against Commercial Credit Plan, Inc., except with respect to declaratory judgment relief which has heretofore been denied, shall continue at trial.

ENTER:

/s/ C. Allen High,
C. ALLEN HIGH, CHANCELLOR
SITTING BY DESIGNATION

ATTORNEYS FOR PLAINTIFFS:

DAVID T. BLACK

ROM MEARES

ATTORNEYS FOR DEFENDANTS:

CUMBERLAND CAPITAL CORPORATION

BY: /s/ William B. Felknor
WILLIAM B. FELKNOR

COMMERCIAL CREDIT PLAN, INC.

BY: /s/ J. W. Baker
J. W. BAKER

AMERICAN CREDIT COMPANY, HOME CREDIT COMPANY OF TENNESSEE, INC., and AMERICAN CREDIT COMPANY OF TENNESSEE, INC.

BY: /s/ B. E. Bernstein
BERNARD E. BERNSTEIN

BFS FINANCE, INC.

BY: /s/ John A. Walker, Jr.
JOHN A. WALKER, JR.

OF COUNSEL

/s/ Val Sanford
VAL SANFORD

IN THE COURT OF APPEALS, EASTERN DIVISION,
AT KNOXVILLE, TENNESSEE
MAY TERM
1982

DECREE

FRED J. ROBINSON, ET AL
(Appellants)

Vs.

CUMBERLAND CAPITAL CORPORATION, ET AL
(Appellees)

and

SHARON HANNUM
(Appellant)

Vs.

COMMERCIAL CREDIT PLAN, INC.
(Appellee)

BLOUNT LAW

Affirmed and Remanded

This cause coming on to be heard upon a transcript of the record from Circuit Court of Blount County, assignments of error, reply brief and argument of counsel, upon consideration whereof the Court is of

opinion that in the judgment of the Court below there is no error.

It is therefore ordered and adjudged by the Court that the judgment of the Court below be in all things affirmed and that this case be and hereby is remanded to the Circuit Court of Blount County for entry and enforcement of its final order as here affirmed, for collection of the costs adjudged in the trial court, and for any further proceedings necessary consistent with the opinion of this Court, a copy of which shall accompany the procedendo upon the remand to the court below.

The costs of this appeal are adjudged in this Court against the appellants, Fred J. Robinson, et al, and Sharon Hannum and

sureties, Rom Meares, Esq., and David T. Black, Esq., for which let execution issue.

Parrott, P.J.
Sanders, J.
Franks, J.

IN THE COURT OF APPEALS OF TENNESSEE

EASTERN SECTION

FRED J. ROBINSON, ET AL Appellants -vs- CUMBERLAND CAPITAL CORPORATION, ET AL Appellees and SHARON HANNUM Appellant -vs- COMMERCIAL CREDIT PLAN, INC. Appellee	BLOUNT LAW HON. C. ALLEN HIGH, JUDGE AFFIRMED

O P I N I O N

Parrott, P.J.

This is another chapter in the litigation from Blount County wherein borrowers sue lenders operating under the Industrial Loan and Thrift Act. Although these two cases have never been consolidated and were heard separately below, we will dispose of them in this Court with one opinion.

In Robinson, et al v. Cumberland Capital Corporation, et al, the plaintiffs have appealed from the circuit judge's dismissing their declaratory relief action without hearing proof. Appellants insist that it was error to deny the declaratory relief and that the order precluding them from offering proof that the defendants intentionally violated Article 11, Section 7, of the Tennessee Constitution amounted to a

denial of the due process of law.

In the original complaint plaintiffs sought a declaration that § 45-4001 et seq., Tennessee Code Annotated, was unconstitutional and the method of computing interest on loans violated the provisions of the Industrial Loan and Thrift Act. Plaintiffs took a nonsuit as to the second contention and proceeded to trial on the declaratory judgment issue.

The main statutory purpose of the declaratory judgment action is "to settle and to afford relief from uncertainty and insecurity with respect to rights, status and other legal relations." T.C.A. § 29-14-113.

It should be noted that the granting of declaratory relief is largely within the discretion of the trial court and the trial judge's action in refusing to make a declara-

tion will not be disturbed on appeal unless such refusal is arbitrary. Southern Fire & Casualty Co. v. Cooper, 200 Tenn. 283, 292 S.W.2d 177 (1956).

Since the filing of this action the Industrial Loan and Thrift Act has been repealed and these plaintiffs assert no claim with respect to the new statute. Thus a declaration of rights to a repealed statute would be meaningless and serve no useful purpose for the future. There is no showing that the circuit judge acted arbitrarily. Under the circumstances we think he acted properly and did not abuse his discretion in finding this was not a proper action for declaratory judgment nor have plaintiffs been denied any constitutional rights. We affirm the dismissal of Robinson, et al v. Cumberland Capital Corporation, et al.

We turn now to the case of Hannum v. Commercial Credit Plan, Inc. in which the plaintiff charges that the defendant's loan charges violated the provisions of the Industrial Loan and Thrift Act. Plaintiff has appealed from the circuit judge's finding there was no violation and dismissal of the action.

We deem it unnecessary to set forth all the detailed computations in regard to the loan received by Sharon Hannum on February 15, 1975. It suffices to say that the circuit judge found and the proof supports that the defendant did not violate the provisions of the Industrial Loan and Thrift Act. In fact, the proof shows that the defendant charged less than the amounts provided for in interest and fees by the Industrial Loan and Thrift Act. R.J. Hodge,

a manager of Commercial Credit with more than twenty years experience, testified in substance that the loan was made in compliance with the Act. Disinterested witness Tom Hamm, Director of the Loan Division of the Department of Insurance of the State of Tennessee, also testified that the loan was made in compliance and did not violate the Industrial Loan and Thrift Act.

Thus the evidence does not preponderate against the findings and conclusions of the circuit judge and we affirm the judgement as entered. Costs are taxed to appellants.

/s/ James W. Parrott,
James W. Parrott, P.J.

CONCUR:

/s/ Clifford E. Sanders,
Clifford E. Sanders, J.

/s/ Herschel P. Franks,
Herschel P. Franks, J.

IN THE SUPREME COURT OF TENNESSEE

AT KNOXVILLE

FRED J. ROBINSON, ET AL.,	)	
APPELLANTS	)	
	)	
VS.	)	BLOUNT LAW
	)	
CUMBERLAND CAPITAL CORPORATION,	)	
APPELLEE	)	

O R D E R

On considering the application for permission to appeal and briefs filed in this case and the entire record, the application of Fred J. Robinson, et al., is denied at cost of the appellants.

PER CURIAM

Supreme Court of Tennessee

CUMBERLAND CAPITAL
CORPORATION,

Appellant,

v.

Hubert D. PATTY,

Appellee.

Aug. 22, 1977

OPINION

HENRY, Justice.

This interlocutory appeal involves the constitutionality of a portion of the Industrial Loan and Thrift Companies Act,[1] and a construction of Article 11, Section 7, Constitution of Tennessee.[2]

I.

Pleadings and Trial Proceedings

Cumberland Capital Corporation, a

Tennessee corporation, organized and existing under the Industrial Loan and Thrift Companies Act, filed its complaint against Hubert D. Patty in the Circuit Court at Maryville, seeking to recover on two promissory notes having an aggregate balance of $61,887.58, together with attorneys fees thereon. It is alleged in the complaint that, simultaneously with the execution of each note, Patty also executed and delivered an appropriate Installment Savings Certificate.

Patty's answer and counterclaim raises a defense of usury. The counterclaim seeks to have the Court decree credit against plaintiff's claims, and a judgment for the usury allegedly paid on other obligations.

By amendment to his answer, Patty asserts that his contract with Cumberland "is

illegal on its face because of violation of Article 11, Section 7 of the Constitution of the State of Tennessee." Additional allegations of usury are set forth, and the Industrial Loan and Thrift Act is assailed as being in violation of Article 11, Section 7 of the State Constitution. It is further alleged that excessive service charges were made by Cumberland.

After hearing testimony, the trial judge, in a memorandum opinion, held that "the loans were usurious under Article 11, Sec. 7 of the Constitution of Tennessee" and that Section 45-2007 was unconstitutional. He further held that "[i]f the lender charges a fee for services that are not rendered or expenses that are not incurred, or if the amount charged exceeds the expended, the excess is interest. . . ." Additionally, he

held that Cumberland was entitled to compute interest at the rate of 10%, "after giving proper credit for loans paid in advance either by money, refinancing, or foreclosure."

A formal order was entered, granting an interlocutory appeal to each party and certifying two controlling questions of law:

1. Are the terms of Tennessee Code Annotated, Section 45-2007, violative of Article 11, Sec. 7 of the Constitution of the State of Tennessee?

2. If the terms of Tennessee Code Annotated, Section 45-2007 are violative of Article 11, Section 7 of the Constitution of the State of Tennessee, is the original complaint entitled to a computation of interest at the rate prescribed by Article 11,

Section 7 of the Constitution of the State of Tennessee?

Cumberland appealed from the holding that Sec. 45-2007, T.C.A. is unconstitutional. Patty appealed from the holding that interest should be computed at 10%.

We are called upon to settle a constitutional issue of first impression and substantial significance. The solution lies in an analysis of Article 11, Sec. 7 of the Constitution of 1870 in the light of earlier constitutional provisions, a succession of statutes, the prior decisions of this Court and pertinent public records.

II.

The Pioneer Period (1796-1835)

Tennessee's first Constitutional Convention, composed of five members from each of the eleven counties of the Territory,

met in Knoxville on January 11, 1796.[3] Twenty-six days after it convened, the Convention adopted our first constitution. It was largely adapted from the North Carolina Constitution of 1776, which basically was the organic law of the Territory of Tennessee, and had been in effect in Tennessee prior to our becoming a Territory.[4]

The Constitution of 1796 does not even contain a passing reference to interest or usury. It is apparent that the delegates to our first constitutional convention believed that the matter of interest addressed itself to the law of the market place and could most effectively be regulated by the legislature, a body created to represent the people and designed to respond to the varying needs and

demands of the state's economic, political, social and cultural affairs.[5]

Under Condition 8 of the Cession Act, Chapter 3, North Carolina Acts of 1789, all the North Carolina acts that were in effect at the time of the cession became effective in the ceded territory. Article 10, Section 2, of the Constitution of 1796 provided:

> All laws and ordinances now in force and use in this territory, not inconsistent with this constitution, shall continue to be in force and use in this state, until they shall expire, be altered, or repealed by the legislature.

Thus, by virtue of the Cession Act and this constitutional provision,[6] Chapter 11, of the North Carolina Acts of 1741, relating to interest, took effect in the State of Tennessee as of June 1, 1796, upon our admission to the federal union. Egnew v. Cochrane, 39 Tenn. 320 (1859).

The North Carolina Act of 1741 provided in pertinent part:

> That no person . . . shall, directly or indirecty take, for loan of any monies, wares, merchandizes, or commodities whatsoever, above the value of six pounds, by way of discount or interest, for the forebearance of one hundred pounds, for one year, and so after that rate for a greater or lesser sum, or for a longer or shorter time. . . .

Violations were punishable by forfeiture of "the double value of the monies, wares, merchandizes and other things so lent, bargained, exchanged, or shifted. . . ."

Thus, at the very outset the amount of interest was restricted and usury was punished severely.

The 1741 Act remained in effect in Tennessee until the adoption on November 13, 1819, of Chapter 32 of the Acts of 1819. This act fixed the legal rate at 6%, provided

for the recovery of excess interest, made usury an indictable offense, and specifically repealed the 1741 Act.

It should be noted at the outset that the practice of discounting was recognized in the 1741 Act and, since the early days of our statehood, has been a practice in this state. In any given commercial transaction involving the practice of discounting, the result must be gauged against existing statutes and constitutional provisions. As the earlier cases are reviewed and analyzed it must be borne in mind that for the first three quarters of a century of our statehood we had no constitutional limitation on interest. Thus, the interest rate, including discount, was governed solely by statute until the Constitution of 1870.

While the practice of discounting is

discussed more fully infra,[7] for present purposes we merely note that discounting is "the taking of interest in advance", Black's Law Dictionary (Rev. 4th Ed. 1968). It is characterized by a transaction wherein the lender deducts the interest from the principal at the time the loan is made.

Our early cases recognize that a note may be sold at a discount, but if the seller agrees that he will be bound for the whole amount of the note, the transaction may be rendered usurious. Campbell v. Read and Gray, 8 Tenn. 392 (1828).

Our early courts were quick to denounce usury, whether arising from discounting or otherwise. See e. g. Nashville Bank v. Hays, 9 Tenn. 243 (1829) and Lawrence v. Morrison, 9 Tenn. 444 (1830). An early case of particular note is Dews v.

Eastham, 10 Tenn. 463 (1830), arising under the Act of 1819. There the borrower attempted to negotiate a cash loan and was told by the lender that he had none to lend but would buy cash notes at the usual discount. The borrower then arranged for his brother to execute notes totalling $112.50, payable to him and by him, endorsed to the lender. The parties agreed to a judgment in a justice of the peace court in the amount of $112.50 payable four months and twenty days later. As a part of this transaction the lender tendered the borrower the sum of $75.00, taking a discount of $37.50, plus 6% on the amount of the judgment, a total interest rate of over "140%". The court held that the "notes were made to sell in the market at a discount" and branded this as "extremely gross" usury and "a high-handed

oppression". 10 Tenn. at 464, 466.

No other cases of any consequence were decided during this period.

III.

Constitution of 1834; statutes, decisional law and other developments leading up to the Constitution of 1870.

a. The Constitution of 1834

The Constitution of 1834 came as a result of the growth and development of Tennessee over a forty year period that saw our state evolve from a primitive society into the early stages of agriculture, manufacturing and cultural pursuits. We outgrew the old Constitution and a new one "was demanded especially to improve the method of levying taxes, electing state officers, avoiding conflicts between the different courts and to promote a good system of inter-

nal improvements . . ."[8]

The population of Tennessee in 1796 was less than one hundred thousand; by 1830 it had risen to 681,902.[9]

The Convention's sixty delegates met in Nashville on May 19, 1834, and remained in session for 104 days, adjourning on August 30, 1834. The finished product was ratified by the people on March 5 and 6, 1835, and became effective with the Governor's proclamation issued on March 27, 1835. The adoption of this Constitution terminated what has been called the "pioneer period" of Tennessee.[10]

The Journal of the 1834 Constitutional Convention is distressingly meager. It reflects that the matter of interest was referred to the Committee on local and private legislation. In submitting its report

on July 24, 1834, the Committee recommended a constitutional provision to read as follows:

> The Legislature shall fix the rate of interest, and the rate so established shall be equal and uniform throughout the State, so that every person and corporation may be allowed the same. But this provision shall not affect existing corporations.

The Committee report reads, in pertinent part, as follows:

> There is nothing by which the best interests of the community may be so soon, and so severely, and so imperceptibly destroyed, as by the mode of regulating the interest on money loaned. The committee believes its great importance deserves a notice in the fundamental law. This clause requires that the Legislature shall fix a rate. (Emphasis in original). This is to prevent the matter from being open to contract, whereby the necessitous may be devoured by the more astute. (Emphasis supplied).[11]

The Convention rejected two formal motions to write in a provision that interest

should not exceed "six per centum per annum." See Journal, Constitutional Convention of 1834, 301, 353.

As adopted, Article 11, Section 6 of the Constitution of 1834 reads as follows:

> The Legislature shall fix the rate of interest, and the rate so established shall be equal and uniform throughout the State.[12]

Again, the Convention left the rate of interest to the judgment and discretion of the legislature. It made it the mandatory duty of the legislature to fix a rate of interest, and required that such rate be equal and uniform throughout the state.

In Perkins v. Watson, 61 Tenn. 173 (1872), the Court stated the purpose of this constitutional provision as follows:

> Notwithstanding the Act of 1819, the Legislature had granted to banks and other moneyed corporations the privilege of taking more than six per cent. for the

> use of money, and these special charters, or rather this privilege granted to them gave rise to sec. 6, Article XI, of the Constitution of 1834, whereby it is provided that "the Legislature shall fix the rate of interest and the rate so established shall be equal and uniform throughout the State." That the object of this provision was to inhibit the legislature from granting the banking corporations the privilege of taking a greater rate of interest than was allowed to individuals, is manifest from the journals of the Convention. (Emphasis supplied). 61 Tenn. at 177.

b. Chapter 50, Public Acts of 1835-1836

This Chapter, captioned "An Act to fix the rate of interest in this State", was adopted February 20, 1836, approximately eleven months after the effective date of the Constitution of 1835.[13] This act made no significant change in the Act of 1819. The rate of interest was fixed at six per centum

per annum, provision was made for the recovery of usury, and usury was made an indictable offense.

c. Decisional law under Act of 1835-1836

A significant portion of our jurisprudence relating to discounting, interest and usury developed in cases arising under this act.

In Ramsey v. Clark, 23 Tenn. 244 (1843), the Court, speaking through Justice Nathan Green, for the first time, drew a distinction between a "business transaction of purchasing a note" and "a negotiation for a loan of money." 23 Tenn. at 245. The sale of a note at a greater discount than six per cent was treated as lawful as opposed to a note made for a loan, which was unlawful and usurious if the discount was greater than six

per cent. See also Gooch v. Massey, 23 Tenn. 374 (1843).

In May v. Campbell, 26 Tenn. 450 (1846), the Court, without citing Ramsey, changed the terminology somewhat by holding that a "real transaction" note discounted at 25 per cent was not usurious, but a note made to raise money and discounted at the rate of 25% was usurious and unlawful. In the one instance there was a real transaction, i.e., the purchase of commercial paper; in the latter a loan.

The holding of May is clarified in Holeman v. Hobson, 27 Tenn. 127 (1847). Involved were several notes, all purchased before maturity and at a discount in excess of the legal rate of interest. In holding the purchases not to be usurious, the Court said:

> [There is a distinction] between a note or bill, in its inception, a real transaction, and a note or bill for the purpose of raising money by sale in market. A transfer by endorsement of the former, though beyond the legal rate of interest, will be regarded as a sale of the note, and a valid and legal transaction; but the endorsement of the latter, being only a nominal negotiation, will be held a usurious contract, if transferred at more than the lawful rate of interest. 27 Tenn. at 129-130.

Hazen v. Union Bank of Tennessee, 33 Tenn. 115 (1853), arose under a charter provision allowing the bank to discount short term paper at the rate of 7 per cent. The Court recognized that the legal rate of interest was 6 per cent; that the "reformed Constitution of 1834" declared that interest would be uniform, and noted that "no law or grant of a franchise can have legal existence which stands in opposition to it." 33 Tenn. at 121. However, the Court, noting the

constitutional provision (Art. 11, Sec. 7) against impairing the validity of existing contracts, held that, because the bank's charter pre-dated the constitution, and was granted at the time when, under the Constitution of 1796, we had no constitutional interest requirements, its charter provisions could stand.

The most interesting and informative case of Wetmore v. Brien, 40 Tenn. 723 (1859), arose under the Free Banking Act of 1851-1852, as amended. Involved was a note discounted at the bank at the rate of 15 per cent. The Free Banking Act provided inter alia that the banks operating under the act "shall not be authorized to discount or shave notes, directly or indirectly, at a greater discount than the other banks are allowed, under existing laws. . . ." 40 Tenn. at 724.

The concluding portion of the opinion is significant:

> The regular business of discounting notes, by deducting from their face the interest for the entire time they have to run, <u>though in itself usurious</u>--as the borrower pays interest on the amount thus deducted--<u>has been long sanctioned by the courts, rather from necessity than upon principle</u>; and thus far the act is plain enough. But the prohibition upon the "Free Banks," not to "shave" notes at a greater rate of discount than the other banks are allowed under existing laws, is not quite so clear. The term "shave" has not, perhaps, heretofore been regarded as a technical term; but in our local jurisprudence, at least, it can no longer be regarded as untechnical, inasmuch as its use is sanctioned by the authors of the "Code of Tennesse."
>
> The <u>popular signification of the phrase "shaving notes," as contra-distinguished from the legitimate business of discounting negotiable paper</u> by the banks, is well understood. The business of purchasing notes, in the market, at less than the amount called for on their face,

or par value, is common amongst individuals in the community; and by the act under consideration, the right to do so would seem to be impliedly conceded to corporations whose business it is to lend money, and exercise other functions of banking--under certain restrictions.

And this business of purchasing negotiable paper is, to a certain extent, sanctioned by law, although the purchaser may thereby get greatly more than legal interest for the use of his money. The distinction is between real transaction paper and paper made for the purpose of raising money by a sale in the market. See [May v. Campbell,] 7 Humph. 450; [Ramsey v. Clark,] 4 Humph. 244. This distinction is important, between a loan, in the form of a sale, and an actual sale and purchase. The purchase must be actual, and made in good faith, and not merely colorable, to cover a usurious transaction. A note made in the course of a real business transaction, for which the original party has given a valuable consideration, is regarded as property; and, like other property, the owner may sell it for the most he can get, and whatever the profit the purchaser may make on his

purchase, there is certainly nothing usurious in it. The owner may be induced, by doubts as to the solvency of the maker, or the pressure of his necessities, to sell the note for less than its face, or less than its market value, and, in the absence of all fraud, this will not affect the validity of the transaction, or impart to it the character of usury. But if the note were made for the purpose of being sold, to raise money, or as an artifice to evade the usury laws, under the color of a sale and purchase of the paper, this will not avail and the purchaser, under such circumstances, with knowledge of the facts, either actual or inferable from the facts of the case, will be held guilty of usury, if the discount shall have been greater than the legal rate of interest. In this sense, the word "shave" is to be understood in the act of 1855-56. And in this sense, and to this effect only, is the business of "shaving" notes, or other negotiable paper, either by individuals or banking corporations, tolerated by law. 2 Pars. on Con. 421. (Emphasis supplied). 40 Tenn. at 726-728.

d. The Legislative Report of 1859-1860

It is readily apparent that "discounting", "shaving" and kindred usurious practices became matters of vital public concern. The Legislature, at the 1859-1860 session, appointed a Joint Select Committee "to investigate the present effect of the Usury Laws of Tennessee; to ascertain the amount of money used in shaving; the amount of domestic capital taken from the State to be used elsewhere, and the average per cent. paid by borrowers for the use of money. . . ." The Committee Report appears as an appendix to the Senate and House Journals of the 1859-1860 Legislative Sessions beginning at page 457. This Committee reported:

1. "that comparatively but little money is now loaned out in Tennessee, at legal rates" (Id. page 457);

2. "that the rate of interest in Tennessee is largely over that which is established by law" (Id. page 458);

3. "that the law fixing that rate for borrowed money, is no longer operative in keeping down the price of money" (Id.);

4. [that law abiding men have no inducement to make loans and] "prefer to place their money on special deposit--to hoard it up, or loan it in other States, whose laws permit something like a fair remuneration for capital" (Id. page 459);

5. that a "large amount has been banished from the state because of our unfortunate legislation, that has arbitrarily fixed the price for the use of money at a standard below its actual value" (Id.); and

6. that the rate of discount in Tennessee ranges between fifteen and twenty-five percent (Id. at 461).

In comparing Tennessee's interest rates at the time with other states, the Committee rather graphically reported:

> The facts, however, show a marked contrast between the rates of

> interest in those States as compared with ours. The tendency and effect of their laws has been to keep capital at home--that of ours to drive it from the State. Their laws invite capital from a distance--ours, on the contrary, repels it from our borders. Their laws protect the borrower, and give him some chance to obtain money at fair rates--ours, on the contrary, create exorbitant rates of interest, and places the borrower at the mercy of the money dealer. (Emphasis in original). Id. at 462.

e. The Act of 1859-1860

Appended to the report was "A Bill to Amend the Usury Laws of the State, and to establish a Conventional rate of Interest." (Emphasis supplied). This proposal passed the legislature as Chapter 41, Acts of 1859-1860, and, thus, we had our first conventional interest law.

Section 1, omitting the enacting clause, provided:

That whenever any person or per-

> sons shall contract for the loan of money, it shall and may be lawful for the lender . . . to receive a rate of interest on the same up to the time when payment is made, not to exceed ten per cent. per annum: Provided, That the parties to the [contract] (sic) shall have so agreed, and such agreement be expressed in the face of the contract, whether the same be evidenced by bond, bill, note or other written instrument. (Emphasis supplied).

It should be noted that this section, in essence, defines conventional interest. It is an agreed rate, and is frequently referred to as contractual interest. It seems to be universally recognized that conventional interest is "the rate agreed upon and fixed by the parties themselves as distinguished from that which the law would prescribe in the absence of an explicit agreement." Black's Law Dictionary (Rev. 4th ed. 1968). See also Hunt Tool Company v. Southern Towing & Salvage Co., 275 F.Supp.

139 (E.D.La.1967); Farnworth v. Jensen, 117 Utah 494, 217 P.2d 571 (1950); Saulsberry v. Wood, 180 Wash. 340, 39 P.2d 592 (1935); Elston, Prince & McDade v. First State Bank of Plain Dealing, 19 La.App. 385, 140 So. 510 (1932); Fowler v. Smith, 2 Cal. 568 (1852); 45 Am.Jur.2d, Interest and Usury, Section 1. The same authorities make it clear that "legal" interest, sometimes called "judicial" interest, is the rate imposed by law in the absence of an agreement. These rates may, or may not, be the same. The distinction between a conventional and a legal rate of interest is crucial to a proper resolution of the question of the constitutionality of Sec. 45-2007(f).

It is beyond question that as early as 1859 our legislative leaders fully knew and understood the differences between legal and

conventional rates of interest.

Section 2, of Chapter 41, Acts of 1859-1860 reads, in part:

> That the rate of interest now established by law, shall continue equal and uniform throughout the State as heretofore; and no greater amount than six per cent. shall be paid on any contract or obligation, unless agreed on by the parties, according to the provisions of the first section of this Act; . . ..

Section 3 specifically authorized the purchase of notes, etc., "made for the purpose of sale, at a rate of discount not to exceed ten per cent. per annum," upon the payment of a privilege tax. Section 8 required that reports be made by February 1, 1861 and each February thereafter of the aggregate amount of all loans made.

In Jackson v. Collins, 49 Tenn. 491 (1870), the purpose of the conventional

interest law of 1860 is stated as follows:

> The object of said statute was to relieve the people, by making it the interest of creditors not to sue, and also to induce capitalists to loan their money, or bring in money from other States and loan it, by increasing the rate of interest; and, under the first section, it was not required that any other part of the agreement should be stated upon the note tha[n] the contract to pay interest at the rate of ten per centum. 49 Tenn. at 498.

This act was passed February 21, 1860, and became effective September 1, 1860. It was in effect for 153 days, being repealed by Chapter 4, Acts of 1861, passed January 31, 1861, one day before the first reports were due. It was, however, construed in several reported cases.

The first, and most significant of these cases, is the controversial case of Caruthers v. Andrews, 42 Tenn. 378 (1865). The note involved provided for interest at

the rate of 10 per cent. The trial judge held Chapter 41, Acts of 1859-1860, to be unconstitutional. The Supreme Court reversed, pointing out that "the constitution imposes no restraint or limit upon the legislature, upon the subject of interest" except that the rate "shall be equal and uniform throughout the state." 42 Tenn. at 386.

The Court treated the Act of 1860 as being an amendment to the Act of 1835,[14] and held that the 1835 act as amended was "equal and uniform throughout the state." The basis for this holding was that all lenders could bring themselves within its provisions. The Court pointed out that "[a]fter the passage of the Act of 1860, as before its passage, there was but one equal and uniform rate of interest . . . which was six per cent. per annum." But, said the Court, under the 1860

act "it was made lawful for any person . . . to take more or less than the legal rate of interest. . . ." 42 Tenn. at 389.

This opinion had serious repercussions and contributed to the action of 1870 Convention.[15]

f. Summary.

The Constitution of 1834 left the rate of interest to the judgment and discretion of the legislature. The object of Article 11, section 6 of that constitution requiring the rate of interest "be uniform throughout the state" was to "inhibit the Legislature from granting the banking corporations the privilege of taking a greater rate of interest than was allowed to individuals". Perkins v. Watson, 61 Tenn. at 172, 177 (1872). Real transaction paper might be discounted at a rate in excess of the legal rate but notes

made for the purpose of raising money might not. May v. Campbell, supra. There could be no valid law authorizing banks to discount at a rate in excess of the legal rate, except where the charter predated the Constitution of 1834. Hazen v. Union Bank of Tennessee, supra. The practice of discounting notes was prevalent during the period; however, we find no case approving the practice where the note or other indicia of debt were executed for the purpose of raising money.

The discounting of notes became a matter of public concern and this led to the appointment of a Joint Legislative Committee. The Committee reported that the going rate of interest was in excess of the legal rate, ranging between fifteen and twenty-five per cent, and that our interest rates were driving capital from the state to the detri-

ment of our economy. The Committee recommended a conventional interest law that was adopted by the legislature, stayed in effect five months and then was repealed. In the meantime, its constitutionality was upheld in Caruthers v. Andrews, supra.

The case law decided under the Constitution of 1834 must be given great weight in construing the provisions of Article 11, Section 7 of our present constitution.

IV.

The Constitution of 1870

The political background is relevant and significant.[16]

a. Background and contemporaneous events.

The legislature convened in Nashville on October 4, 1869. It acted with

dispatch. It adopted a resolution[17] on November 15, 1869, submitting the question of calling a convention to a vote of the people in a special election to be held on December 18, 1869. The election was conducted, delegates selected, and thereafter the convention met on January 10, 1870, in the Davidson County Courthouse in Nashville.[18] We presume the courthouse was selected as the convention site in view of the fact that the legislature was in simultaneous session during the entire course of the convention.

The basic and underlying purpose of the convention was the restoration of the citizenship of thousands of Tennesseans disqualified under Parson Brownlow's franchise acts.[19] Notwithstanding the emotionally charged political atmosphere, this convention was marked by restraint. In fact,

it has been said that "the true policy was to do as little as possible."[20] Delegate A.O.P. Nicholson, later Chief Justice of this Court sounded the key-note:

> Let us be careful; let us do no more than is absolutely necessary. In ten years from now all this must be done again.[21]

There seems to be a unanimity among historians that this convention of seventy-five Tennesseans "was, probably, the most intellectual body of men ever assembled in Tennessee for any purpose.[22]

Major General John C. Brown, of Giles County, who served as governor from 1871 to 1875, was elected as chairman. His older brother, former Governor Neill S. Brown, was an influential member of the convention. David M. Key, who succeeded Andrew Johnson in the United States Senate, served as Postmaster-General under President Hayes, and

became a United States District Judge in 1800, [sic] was another outstanding member of the convention. Other distinguished members included future Governor James D. Porter, Joseph B. Heiskell, a former member of the Confederate Congress and afterwards Attorney General of Tennessee (See Volumes 48-59, Tennessee Reports); and Chancellor Henry R. Gibson, famed author of Gibson's, Suits in Chancery.

The most distinguished delegate was probably A.O.P. Nicholson. He served in the Senate of the United States and as the first Chief Justice under the Constitution of 1870.

Such was the leadership of the 1870 Convention. While the primary purpose of that convention was political and few changes of major importance were made in the Constitution of 1834, a significant change

was made in the constitutional provision relating to interest. The conventional interest law of 1859-1860 had been repealed, but conventional interest continued as a critical issue.

On November 4, 1869, after the introduction of a bill to establish a conventional rate of interest, Representative R.B. Cheatham addressed the House of Representatives. His remarks are reported verbatim in the November 5, 1869 issue, of the Nashville Union and American, page 1, and constitute a most forceful argument in favor of the law. We quote a portion:

> . . . Money is worth in the market whatever it will bring. Laws saying it shall only be worth six per cent. do not fix its price; and no licensing or penal regulations can govern the price, or restrain the sale at whatever price it may bring. . . .
>
> It is evident that our laws pro-

> hibiting money to be loaned, and contracts to be made at any higher rate of interest than six per cent has been for years, and is still, not only preventing foreign capital from coming into Tennessee, but has driven out, and is continually driving millions of our capital into other States with more liberal laws, and forcing it into investments which are non producing. Money to-day in our own midst, and in every State surrounding us, is worth from 8 to 12 per cent. per annum, and is so recognized by all classes. The farmer, the trader, the manufacturer cannot get it at 6 per cent., the price fixed by law. They have ceased to expect it. They do not ask it. Being unable to borrow it from private individuals or from estates of any kind on any kind of security, on account of the usury laws as they exist, they are forced to go into the bank on paper inconveniently short, or to go to <u>shavers</u> who are compelled, on account of these same laws, to exact exorbitant rates.

This argument, like the Joint Committee report of 1859, has a familiar ring and one that continues to be sounded today.

Representative Salder of Robertson County addressed the House of Representatives in opposition of the bill. His remarks are reported on page 1, Nashville Union and American, November 27, 1869. In obvious reference to Caruthers v. Andrews, supra, Mr. Sadler said:

> I am aware of a decision of the Supreme Court on the old ten per cent. law that has been acknowledged by an eminent lawyer in this house to be at least a doubtful decision, and there is no good lawyer but will acknowledge, when we have a strong bench, this decision may be reversed.

On December 4, 1869, the Nashville Union and American published an editorial endorsing the conventional interest law. After reviewing the report of the Joint Committee of the 1859-1860 legislature, the editorial reads:

> What was true of this State ten years ago, is equally so to-day. Money is worth more than six per cent, not only in Tennessee but in every State of the Union. . . .

Again, on February 6, 1870, the Nashville Union and American editorially urged passage of the conventional interest law. The editorial recognizes the argument that a conventional interest law is unconstitutional and counters it by extensive quotation from Caruthers v. Andrews, supra.

Thus, it appears that conventional interest was extensively debated prior to and during the time the Constitutional Convention and the legislature were deliberating.

b. The proceedings.

We have examined the Journal of the Constitutional Convention of 1870 in an effort to determine the intent of the convention. The matter of interest rates was

the subject of many motions.

On February 21, the Journal reflects that the Convention adopted Article 11, Sec. 6 "as amended, giving the Legislature power to pass a conventional rate of interest not to exceed ten per centum per annum."[23] This operated to complete the formulation of the present provision.

On Wednesday morning, February 23, 1870, the Convention proceeded in a body and presented the enrolled copy of the Constitution to the Governor.[24]

In its final form Article 11, Section 7, read as follows:

> The Legislature shall fix the rate of interest, and the rate so established shall be equal and uniform throughout the State; but the Legislature may provide for a conventional rate of interest, not to exceed ten per cent. per annum.[25]

In summary, it appears from the pro-

ceedings of the Convention that the delegates, in order:

a. rejected an amendment giving the legislature the power to fix a conventional rate of interest;

b. rejected an amendment authorizing a rate of ten per cent for loaned money;

c. rejected an amendment fixing a legal rate of interest at 6 per cent with the legislature fixing a conventional rate;

d. rejected a committee report containing a proposed section under which the rate was fixed at 6 per cent but made lawful any rate agreed upon by the parties, inserted in a written contract, not to exceed 10 per cent;

e. adopted Article 11, Section 6, Constitution of 1834 (the first clause of Article 11, Section 7, Constitution of 1870);

f. adopted an amendment: "but the Legislature may provide for a conventional rate of interest";

g. adopted an amendment providing that the Legislature shall have no power to enact any law allowing a higher rate of

interest than ten per cent. per annum"; and

h. adopted an amendment giving the legislature power to pass a conventional rate of interest not to exceed ten per cent.

These proceedings, in orderly progression, combined to produce the final version of Article 11, section 7 of the Constitution.

c. Analysis.

We think that the language used, in the context of the statutory and decisional law, public debates, and public documents, leading up to its adoption compels these conclusions:

a. The legislature must fix a rate of interest.

b. The rate so fixed must be equal and uniform throughout the state.

c. The legislature may provide for a conventional rate of interest.

d. A conventional rate of interest must not exceed ten per cent.

All legislative enactments must yield to this, our basic charter, and must be tested against these plain provisions. Statutory enactments relating to usury are of only passing relevance. The Constitution contains no provision against usury except that which is implicit in the second clause of Article 11, section 7.

We set to rest, at this point, the suggestion so often heard that our Constitution fixes a ten per cent limitation on interest. This is a misconception. The legislature, under the first clause of Article 11, section 7, may fix any legal rate of interest it deems proper. It is not required to fix a conventional rate. We point out that no part of Article 11, section

7, is self-executing.

If, however, the legislature elects to fix a conventional rate of interest it is limited to ten per cent.

Our Constitution contains the conventional interest clause and the phrase "conventional interest" had a particularized legal significance in 1870 and that meaning has not changed. See supra, Sec. III e. Again, the distinction between conventional and legal rates of interest is crucial.

We recognize the insistence that the insertion of a fixed limitation in a constitution or other basic charter, and thus constitutionalizing with fixed rigidity, matters better left to statutory flexibility, violates recognized principles. Indeed, this has been said to be "the chief criticism of the 1870 Constitution by most scholars."[26]

This contention harmonizes with Justice Cardozo's statement in The Nature of the Judicial Process, 83 (1921), that "a constitution states or ought to state not rules for the passing hour but principles for an expanding future." Thus, under this view it is the duty of a constitutional convention to achieve a balance between the demands of stability and the need for change.

Be this as it may, the second clause of Article 11, section 7 is in our Constitution. Its meaning is plain; our duty is clear. We shall enforce it.

V.

Our second conventional interest law

We have seen that during the entire Convention of 1870 the General Assembly was in simultaneous session. Two days after the

Convention finalized its action on Article 11, section 7 and on February 23, 1870, the very day and date the finished Constitution was presented to the Governor, the Legislature adopted our second conventional interest law, Chapter 69, Public Acts of 1869-1870.

Section 1 provided that "it shall be lawful to contract for any rate of interest not exceeding ten per cent. per annum, provided that the rate of interest be in writing and expressed in the face of the instrument. . . ."

> Section 2 provided:
> That the rate of interest now established by law shall continue equal and uniform throughout the State as heretofore, and no greater rate of interest than six per cent. per annum shall be received on any contract or obligation, unless agreed on by the parties, and reduced to writing in the face of the contract or obligation, according

to the provisions of the first section of this Act.

This Act was repealed by Chapter 21 of the Acts of 1877, with the result that the Act of 1835, as codified in the Code of 1858 was again effective.

VI.

Decisional law since 1870

Cases decided under the Constitution of 1870 add no dimension to earlier cases decided under the Constitution of 1834 and/or statutes governing conventional interest. Some, however, are relevant, and because able counsel urge differing construction, we note those we consider to be most significant.

Counsel for Cumberland Capital relies upon Chafin v. Lincoln Savings Bank, 54 Tenn. 499 (1872), opinion by Chief Justice Nicholson, aptly described in brief as "one

of the chief architects and builders of the constitution of 1870" (quoting 113 Tenn. at 736). Counsel relies upon this opinion as "approving discounting at the legally permissible rate." We cannot accept the implications of this construction.

In Chafin the facts were that the bank had discounted, at a rate of 15 per cent, a note that was made for the purpose of raising money. The Court held that the fact that the note was made to be sold for the purpose of raising money, and that the bank knew this, made the transaction illegal and usurious. The court said, in pertinent part:

> Although in strictness the term "discount of notes," originally meant the purchase of real transaction notes, as contradistinguished from mere accommodation notes, yet in practice the distinction has been too long disregarded, and has been too often ignored in our legislation, to be now made the ground of a

> judicial decision. The lending of money is one of the legitimate franchises of a bank, and it exercises this privilege when it discounts a note which it knows was made for the purpose of raising money. The bank lends its money and takes the note of the borrower as security for its repayment. If the loan is made at a rate of interest or discount not exceeding 6 per cent., the transaction is legitimate. If the note was discounted, or the loan made at a greater rate than 6 per cent., the transaction is illegal and usurious. . . . (Emphasis supplied). 54 Tenn. at 501-502.

We read nothing in this opinion that would validate any discounting that would result in a rate of interest in excess of the constitutional or statutory limit. The construction contended for by Cumberland, would not only be at variance with the constitutional limitation, it would nullify its own meaning.

It is true, as contended by Cumberland,

that the Court held in Crowley v. Kolsky, 57 S.W. 386 (Tenn. Ch. App. 1900) that a lender has a "right to deduct legal interest until the maturity of the note, --that is to exact prepayment of legal interest. . . ."

We do not regard this as a precisely correct statement of the law. It is correct if, but only if, two criteria are met. First the repayment must be on an annual basis and secondly, the rate must be less than 10%. This follows from the fact that a note in the sum of $100.00, payable at the end of the year, when discounted at the rate of ten per cent, gives the borrower a net of $90.00. For the use of that for one year he pays approximately 11.1% interest and this rate, therefore is constitutionally impermissible. For further computations see Appendix.

Cumberland contends that Caldwell &

Co. v. Lea, 152 Tenn. 48, 272, S.W. 715 (1924) "must be considered as the single most authoritative pronouncement on the meaning and scope of Article XI, section 7." While we agree that the opinion is authoritative, we are not impressed that it is supportive of Cumberland's position.

Caldwell arose under Chapter 69 of the Acts of 1925 authorizing corporations, firms and individuals to issue bonds or notes aggregating $50,000.00 or more at a rate not to exceed seven and one half (7½%) per cent. The Court held the act to be constitutional.

The opinion points out that Section 7 of Article 11 of the Constitution "except requiring the legislature to fix an interest rate adds nothing to section 8 of article 1 [law of the land], and section 8 of article 11 [class legislation], of the present

constitution." 152 Tenn. at 52, 272 S.W. at 716. Then the Court said:

> We may lay aside so much of section 7 of article 11 as authorizes the legislature to provide for a conventional rate of interest. 152 Tenn. at 52, 272 S.W. at 716.

Next, the Court notes the provisions of Article 11, section 6 of the Constitution of 1834, and cites Caruthers, supra, and McGhee v. Trotter, 48 Tenn. 453, as being two cases wherein the Court held "that the legislature was empowered to fix a contract rate . . . not exceeding ten per cent was valid." Id. These two cases were decided under our first conventional interest law (Ch. 41, Acts of 1859-60).

Thus, the Court reaches the only question in the lawsuit, viz whether the classification made in the Act of 1925 was

reasonable. The Court responded in the affirmative. In so doing the language of the opinion by Justice Green is most significant.

> The object of the provision of section 6 of article 11 of the Constitution of 1834, carried into section 7 of article 11 of the Constitution of 1870 that the interest rate should be equal and uniform was to cut off the grant of charter powers to banks and moneyed institutions to exact a greater rate than individual lenders were permitted to obtain." (Emphasis supplied). 152 Tenn. at 53, 272 S.W. at 716.

The derivation and the background of the first clause of Sec. 7, Art. 11 is explained as follows:

> Under section 7 of article 11 of the Constitution of 1834 the legislature was authorized "to grant such charters of corporation as they might deem expedient for the public good." The legislature had been empowering banks by their charters to contract for a special rate of interest, and section 7, just quoted apparently authorized a continuance of this practice.

> Section 6 of the Constitution of 1834 [now sec. 7, art. 11] was adopted to prevent the grant of any special power of this sort. (Emphasis supplied). Id. at 54, 272 S.W. at 716.

In the meantime, in 1921 the legislature adopted our third conventional interest law. See Chapter 28, Acts of 1921. It was repealed by Chapter 5, Acts of 1923. Again, the Act of 1835, as codified in the Code of 1858, became operative.

The record suggests that Tennesseans cannot live with a conventional interest law and cannot live without one.

The constitutionality of the 1925 Small Loan Act (Ch. 69, Acts of 1925) was upheld in Koen v. State, 162 Tenn. 573, 39 S.W.2d 283 (1931). This act fixed the interest charge at six per cent. This case was primarily concerned with service fees and is discussed infra.

In Dowler v. Ga. Enterprises, Inc., 162 Tenn. 59, 34 S.W.2d 445 (1931), the Court held (1) that partial payments on interest bearing obligations must be applied first to interest and second to principal; (2) that this rule "may be varied by contract if it does not savor of usury", 162 Tenn. at 63, 34 S.W.2d at 446; (3) that in interest computation a year is 365 days; and (4) that shortening the year to 360 days results in usury.

Rush v. Dupont Emp. Cr. Union, 210 Tenn. 344, 358 S.W.2d 333 (1962), arose under the credit union statutes, Sec. 45-1801 et seq. T.C.A. Section 45-1820 authorizes a credit union to lend to its members "at a rate of interest not in excess of the legal rate, and the total interest and all other charges for a loan shall not exceed one per

cent (1%) per month on the unpaid balance. . . ." Citing Sec. 47-1604 (now 47-14-104) T.C.A. fixing the rate of interest at 6%, the Court held a note payable "with interest on unpaid balance at the rate of one per cent per month" was usurious on its face and unenforceable. The Court declined to permit the introduction of parol evidence to show that the word "interest" as used in the note included "all other charges."

VII.

The Industrial Loan & Thrift Act

Industrial Loan & Thrift Companies have their Tennessee origin in Chapter 226, Public Acts of 1951. We are concerned only with those portions of the original and amendatory acts as relate to interest. Initially, in this respect, the act simply

authorized such companies:

> To lend money on the personal undertaking of a borrower or other persons, with or without security including certificates of indebtedness or investment purchased by the borrower simultaneously with the said loan transaction, or otherwise, and to deduct interest in advance on the face amount of the loan for the full term thereof.[27] See Sec. 45-2007(f) (Main vol. 8)

While the act was in this posture there came before the United States District Court for the Western District of Tennessee the case of In Re Bogan, 281 F. Supp. 242 (W.D. Tenn. 1968). The question presented was whether a note forming the basis of a Loan and Thrift Company bankruptcy claim was usurious. The debtor signed a note for $612.00, received the use of $556.08 and agreed to repay at the rate of $34.00 per month, for a period of 18 months. The Court held this to be interest at the rate of

approximately 12 per cent per annum.[28]

Judge McRae's opinion contains the following significant language:

> It should be noted that this court does not consider that it was called upon to determine the constitutionality of the Industrial Loan and Thrift Act; nor does it intend to hold that any portion thereof is violative of the Constitution of the State of Tennessee. The Court does hold that the Act must be interpreted to be limited by Article 11, Section 7 of the Constitution of Tennessee. The Court, therefore, finds in the instant case that the claim note was usurious on its face because it shows that the interest provided was in excess of the constitutional maximum. 281 F. Supp. at 248.

After In Re Bogan was decided, the legislature adopted Chapter 466 of the Public Acts of 1968, relating to refunds and refund credits. Then, by Chapter 260, Acts of 1969,

Sec. 45-2007(f) was put in its present form. In pertinent part, it now reads as follows:

> To lend money on the personal undertaking of a borrower or other persons, with or without security including certificates of indebtedness or investment purchased by the borrower simultaneously with the said loan transaction, or otherwise, and to deduct interest at a rate not in excess of 7½% per annum, in advance on the face amount of the loan for the full term thereof. (Emphasis supplied).

The constitutionality of this portion of the act is the basic issue before the Court.

VIII.

Constitutionality of Sec. 45-2007(f)

Sec. 45-2007(f), T.C.A. must be construed to provide for a conventional rate of interest. This construction is a necessary consequence of the conclusion that conventional interest arises by contract and

is an agreed rate. That this was the evident intent of the legislature may be gleaned from the fact that Section 47-14-104, T.C.A., the general law regulating interest fixes both a legal and a conventional rate and excepts Industrial Loan and Thrift Companies from the application of the conventional interest provision. Chapter 61, Acts of 1969 became effective April 10, 1969, twenty-five days before the effective date of Chapter 260 of the Acts of 1969 amending the Industrial Loan and Thrift Act. The latter act specifically regulates the rate of interest charged by Industrial Loan and Thrift Companies, and, as the latest, and as a specific act, it would supersede all others.

Section 45-2007(f) must, therefore, be tested against Article 11, Section 7 of the Constitution. If it provides for an interest

rate within the ten per cent constitutional limitation on conventional interest, it is constitutional; but if the rate provided results in a yield in excess of ten per cent it is unconstitutional and void.

Section 45-2007(f) expressly authorizes Industrial Loan and Thrift Companies "to deduct interest at a rate not in excess of seven and one-half per cent (7½%) per annum, in advance on the face amount of the loan for the full term thereof." This is discounting in its purest form. But this fact, standing alone does not render the act unconstitutional. This determination rests upon mathematical computations.

The notes involved in this litigation were, in legal effect, monthly installment obligations, discounted in advance. In the Appendix we have made calculations showing

the effective interest rate upon the advance discounting of such installment loans.

The inescapable result of these computations in that Section 1 of Chapter 260 of the Public Acts of 1969, which appears in the Code Supplement as Sec. 45-2007(f) is unconstitutional and void, insofar as it is applied to any note or obligation, discounted at 7½% per centum and payable in monthly installments, or to any other transaction, regardless of how payment is programmed, if the end result is an effective rate of interest in excess of ten per cent.

IX.

The applicable interest rate

The question now arises as to what rate of interest the notes in litigation should bear.

The trial judge held that the interest

on the various loans should be computed "at ten per centum per annum, giving proper credit for loans paid in advance either by money, refinancing or foreclosure." This conclusion is not entirely correct.

There is no specific legal sanction for permitting an Industrial Loan and Thrift Company to exact an interest charge of ten per cent. Section 47-14-104, T.C.A. authorizing a ten per cent conventional interest shows on its face that that interest rate does not apply to Industrial Loan and Thrift Companies. Sec. 45-2007(f) authorizes these companies to deduct interest of up to seven and one-half per cent in advance. We have demonstrated that this operates to produce a rate in excess of ten per cent on installment obligations.

We hold that the declaration of the

limited unconstitutionality of Sec. 45-2007(f), T.C.A., operates to restrict Industrial Loan and Thrift Companies to a maximum effective rate of interest, irrespective of the manner of payment, of ten per cent, the constitutionally permissible maximum.

On remand interest will be computed on a 7½ per cent discount basis with the qualification that the effective rate of interest shall not exceed ten per cent. The trial judge will bear in mind that the inquiry must be directed at what the lender will receive and not what the borrower will pay. The trial judge is admonished that all proper credits be given to the respective parties.

In view of the disposition we have made we do not deem it necessary to discuss the facts and figures with respect to any of

the loans involved. The trial judge has indicated that these complex matters would be referred to a special master. We approve this procedure. We point out that our use of the constant ratio forumla in the Appendix is only for purpose of analysis and demonstration. On remand, inquiry should be made, and proof should be taken, as to other methods of computation and the trial court, based thereon, may make a proper determination.

X.

Service Charges and Maintenance Fees

Technically, we perhaps have responded to the two questions certified; however, question number one is sufficiently broad to cover all pertinent portions of Sec. 45-2007, T.C.A. We note appellant's assignment VII, which reads as follows:

The Circuit Court erred in fail-

> ing to hold that Section 45-2007(i), (p) and (q), in defining and regulating service charges and maintenance fees . . . is constitutional.

We elect to respond to this assignment because we think it fairly within the purview of question one; further, it is necessary that we treat [it] with this insistence for the guidance of the trial judge on remand. This Court has addressed this matter in numerous reported cases, from which these rules emerge:

1. The Legislature may not authorize a lender to arbitrarily fix a monthly expense fee. Koen v. State, 162 Tenn. 573, 39 S.W.2d 283 (1931); Personal Fin. Co. v. Hammack, 163 Tenn. 641, 45 S.W.2d 528 (1932), nor to charge all borrowers the maximum fee, in addition to interest. Family Loan v. Hickerson, 168 Tenn. 36, 73 S.W.2d 694 (1934).

2. The lender and the borrower are free to agree upon a reasonable service charge within the statutory limit. Koen v. State, supra; but his "freedom of contract" is limited by Article 11, Section 7 relating to conventional interest, Pugh v. Hermitage Loan Co., 167 Tenn. 389, 70 S.W.2d 22 (1934), and is further limited and governed by other principles set forth in this sequence.

3. Service charges must bear a reasonable relation to the expense and service of the lender. Pugh v. Hermitage Loan Co., supra.

4. When the service charge is within the statutory limits it is prima facie valid, and the burden is on the borrower to show by a preponderance of the evidence that the charge does not bear a reasonable relation to expenses and services. Family Loan Co. v.

Hickerson, supra. When the borrower makes out a prima facie case, the burden shifts to the lender. Golightly v. Hermitage Loan Co., 171 Tenn. 70, 100 S.W.2d 654 (1937). The burden is on the borrower to show that the loan is usurious. Williams v. Personal Finance Co., 172 Tenn. 69, 109 S.W.2d 1166 (1937).

5. The service charge amounts to usury if exacted as additional compensation for the use of money in attempted evasion of the statutes against usury. Pugh v. Hermitage Loan Co., supra.

6. The service charge may not include overhead expenses such as rents, salaries, and loan losses, Family Loan Co. v. Hickerson, supra, but this does not preclude charging for services directly related to the loan rendered by salaried employees. It only

excludes indirect or extraneous expense. Williams v. Personal Finance Co., supra.

As we said in Aztec Prop. v. Union Planters Nat. Bank, etc., 530 S.W.2d 756 (Tenn. 1975):

> Interest includes all compensation for the use of money. "Any payment to the lender in addition to the rate of interest legally permissible, whether called by the name of bonus or commission or by any other name, is usurious." (Emphasis supplied). 530 S.W.2d at 757.

We hold that any service charge in excess of the fair and reasonable worth of expense and service attributable directly to a loan must be treated as additional compensation to the lender and constitutes interest. Any such excess must be added to the stated, or resulting, amount of interest in order to determine the validity of the charge. The excess, of course, is conven-

tional interest.

Installment maintenance fees, as set forth in Sec. 45-2007(h) are to be governed by the same rules.

We do not hold Sections 45-2007(i) or (p) to be unconstitutional. We do hold, that, in order to sustain the constitutionality of these sub-sections, they must be construed and interpreted as hereinabove set forth, and not as established, uniform, fixed, rigid or arbitrary charges, the provisions of subsection (q) to the contrary notwithstanding. See Family Loan Co. v. Hickerson, supra, 168 Tenn. at 42, 73 S.W.2d 694 and Pugh v. Hermitage Loan Co., supra.

We do not test legislative enactments by our conception of morality or merit. Our sole duty is to insure that legislation complies with the mandates of our Consti-

tution. Nor are we privileged to sit in judgment on the merits of constitutional provisions. We may only construe and abide them and mandate that they be respected.

Modified, Affirmed and Remanded.

COOPER, C.J., and FONES, BROCK and HARBISON, J.J., concur.

FOOTNOTES:

1. Sec. 45-2001, et seq., T.C.A.

2. The Attorney General of Tennessee lodged with this Court an intervening petition taking the position that the constitutional issues "are fully presented by both parties and that the interests of the state do not require the Attorney General to be further heard." We approve his action and concur in his comment. Indeed, the briefs submitted by counsel for the respective parties and those appearing as Amicus Curiae, articulate the issues with conspicuous skill and ability.

3. While subsequent constitutional conventions may lay claim to higher intellectual attainments, the Convention of 1796 was undoubtedly composed of more Tennesseans of prominence in public affairs. Davidson County, for example, was represented by

Andrew Jackson, seventh President of the United States, James Robertson, founder of Nashville, and John McNairy, our first federal judge, who served in that capacity for forty years. Future Governor Joseph McMinn and future United States Senator William Cocke represented Hawkins County. Other members were Joseph Anderson of Jefferson County, who served as a United States Senator for sixteen years and as Comptroller of the Treasury of the United States, William Blount of Knox County, the Territorial Governor, James White, the founder of Knoxville, and Judge William C. C. Claiborne, first Governor of the Mississippi Territory and later Governor of Louisiana. See J. Caldwell, Constitutional History of Tennessee, 130-132 (1907).

4. Ibid., p. 133.

5. Thirty-seven states of the Union have no constitutional provisions relating to interest.

6. See also Art. 11, Sec. 1, Constitutions of 1834 and 1870 for similar continuation clauses.

7. See Section III infra.

8. J. Moore, Tennessee, The Volunteer State, 404-405 (1923).

9. 2 R. White, Messages of the Governors of Tennessee, 444 (1952).

10. 2 R. White, Messages of the Governors of Tennessee, 443 (1952).

11. Journal, Constitutional Convention of 1834, at 161.

12. It will be noted that this is precisely the same language as is contained in the first clause of Article 11, Section 7, of the Constitution of 1870.

13. This act was the basis of Sec. 1944 of the Official Code of 1858, and of Sec. 47-14-104, T.C.A.

14. The 1860 Act contains no specific repealing clause.

15. See Sec. IV, infra.

16. Tennessee, torn by war and devastation, suffered under the despotic, tyrannical, and dictatorial regime of William G. "Parson" Brownlow from April 1865 until April 1869--four long years. As the guiding genius of a subservient legislature he "not only disfranchised the overwhelming majority of Tennessee's citizens, but pursued them constantly with additional hostile legislation." See 5 R. White, Messages of the Governors of Tennessee, 395 (1959). He was vicious, vindictive, coarse, and vulgar, his avocation as a minister of the gospel to the contrary notwithstanding.

The ruthless regime of the Radicals in Tennessee is well documented. Id. at 373-390. In no area was this more evident than in the Arnell law, Chapter 16, Acts of 1865, an iniquitous, disfranchising act operating to deny suffrage to all but a pri-

vileged few. Laska, A Legal and Constitutional History of Tennessee, 6 Memphis State L.Rev. 563, 628-629 (1976).

The Parson appointed the members of the Supreme Court in the face of the statutory requirement that they be elected. 5 R. White, Messages of the Governors of Tennessee 576, 596 (1959); Id., vol. 6, p. 8. It was this Court that decided Caruthers v. Andrews, supra. No doubt this Court was convicted of guilt by association, but the fact remains that its decisions, as reported in Volumes 41-47, Tennessee Reports were designated by contemporary lawyers as "Coldwell's Fables." Green, The Supreme Court of Tennessee in 1878, 16 Tenn.L.Rev. 767, 768-69 (1941).

Upon Parson Brownlow's election to the United States Senate, he was succeeded by DeWittSenate. 6 R. White, Messages of the Governors of Tennessee 1 (1963). Senter soon broke with the Radical faction, removed the majority of Brownlow's election commissioners, and appointed Conservatives in their stead. After what has been characterized as "perhaps the most bitterly fought gubernatorial contest ever waged in the Volunteer State", he was re-elected in 1869 in an election open to all citizens. Along with him was elected a Democratic Legislature. During the campaign, Governor Senter had called for a constitutional convention. This election broke the strangle hold of the Radicals. Ibid. 2, 3.

17. Chapter 105, Acts of 1869.

18. Nashville Union and American, January 11, 1870, page 1.

19. J. Caldwell, Constitutional History of Tennessee 296 (1907); 1 J. Moore, Tennessee, the Volunteer State 552 (1923).

20. J. Caldwell, Constitutional History of Tennessee 299-300 (1907).

21. Ibid, 300.

22. J. Caldwell, Constitutional History of Tennessee 298 (1907); 1 J. Moore, Tennessee, the Volunteer State 551 (1923); 6 R. White, Messages of the Governors of Tennessee 84 (1963); Laska, A Legal and Constitutional History of Tennessee, 6 Memphis State L.Rev. 563, 635 (1976).

23. Journal of Constitutional Convention of 1870, page 386.

24. Id. at 406, 440.

25. Id. at 436.

26. Laska, Legal and Constitutional History of Tennessee, 6 Memphis State L.Rev. 563, 635 (1976).

27. The interest rate was governed by Sec. 47-14-104, the general statute, fixing the rate of interest, as it existed at that time.

28. Actually, the rate was 12.7%. See Appendix.

ADDENDUM

Tax all costs against Cumberland Capital.

APPENDIX

For purposes of these computations we will assume a loan of $100.00, bearing interest at the rate of 7½%. If this loan is discounted in advance and is payable at the end of one year, the resulting yield is approximately 8.00 per cent, which is constitutionally permissible. If it is payable monthly, and on a declining balance basis it is not constitutionally infirm. But discounted or add-on interest, payable in installments, present an entirely different result.

There are a number of different methods for the computation of interest rate of yield.[1] We have elected to use the "uniform" or "constant" ratio method, because

of its simplicity and accuracy. This method assumes that the allocation of the charge is proportional to the number of periodic payments, with the result that each periodic payment reduces the charge by constant amount and principal by another constant amount.[2]

This formula[3] is

$$i = \frac{2mD}{P(n+1)}$$

in which i = rate of charge (effective rate)
m = number of payment periods in one year
n = number of payments to discharge the debt
D = charge in dollars
P = principal

We apply this formula to a loan having a face value of $100.00 with discount at the rate of 7½% payable in twelve equal monthly installments. The borrower was tendered $92.50 at the time of the loan. This tabulation shows the resulting rate of interest:

$$i = \frac{2 \times 12 \times 7.50}{92.50 \times (12 + 1)} = \frac{180.00}{1202.50} = .14968 = 14.97\% \text{ interes}$$

Using the same formula, we demonstrate its application in the case of a loan having a face value of $100.00 at an add-on interest rate of 7½% payable in twelve equal monthly installments:

$$i = \frac{2 \times 12 \times 7.50}{100 \times (12 + 1)} = \frac{180}{1300} = .13846 = 13.85\% \text{ interest.}$$

By a further example, we show that a 7½% annual discount rate on a note of $100.00 payable in four equal monthly installments results in a somewhat lower effective rate:

$$i = \frac{2 \times 12 \times (7.50 \times 4/12)}{[100-(7.50 \times 4/12)] (4 + 1)} = \frac{60}{487.50} = .12307 = 12.31\% \text{ interest}$$

In this example note that the value for "m" remains the same as in previous examples since the frequency of payment is the same; the value for "n", however, reflects the shorter period of this loan.

By final example we show the cost rate by the constant ratio method for a balloon note. The formula, as set forth in M. Neifeld's Guide to Installment Computations 207 (1951), is:

$$i = \frac{2mAD}{Pn(A + L)}$$

in which D = charge in dollars
P = principal or cash advance
A = P + D = face of the note
m = number of payment periods in one year
n = number of payments to discharge the debt
i = rate of charge
L = final or ballon payment

We apply this formula to one of the transactions in the instant controversy where the indebtedness was $70,629.87 payable in 35 monthly installments of $1,600.00 with a final or balloon payment of $14,629.87, with interest of $15,883.62 and finance charge of $380.60 deducted in advance. The computation is as follows:

(using total charge)

$$i=\frac{2 \times 12 \times 70,629.87 \times 16,300.22}{54,329.65 \times 36\ (70,629.87 + 14,629.87)}=16.569$$

(using interest only)

$$i=\frac{2 \times 12 \times 70.629.87 \times 15,883.62}{54,329.65 \times 36\ (70,629.87 + 1,462.87)}=16.146$$

The annual percentage rate entered by Cumberland Capital was 15.25, computed according to Regulation Z. We do not fault this computation. Irrespective of the formula or method there will be a slight variation.

The following chart on effective interest rates demonstrates the results of discounts and add-ons at various interest rates calculated by the formula first given above.

EFFECTIVE INTEREST RATES on LOANS PAID in MONTHLY INSTALLMENTS

Length of loan in months	6% Discount	6% Add-on	7½% Discount
1	6.03	6.00	7.55
2	8.08	8.00	10.13
3	9.14	9.00	11.46
4	9.80	9.60	12.31
5	10.26	10.00	12.90
6	10.60	10.29	13.36
7	10.88	10.50	13.73
8	11.11	10.67	14.04
9	11.31	10.80	14.30
10	11.48	10.91	14.55
11	11.64	11.00	14.77
12	11.78	11.08	14.97

	7½% Add-on	10% Discount	10% Add-on
1	7.50	10.08	10.00
2	10.00	13.56	13.33
3	11.25	15.38	15.00
4	12.00	16.55	16.00
5	12.50	17.39	16.67
6	12.86	18.05	17.14
7	13.13	18.58	17.50
8	13.33	19.05	17.78
9	13.50	19.46	18.00
10	13.64	19.83	18.18
11	13.75	20.18	18.33
12	13.85	20.51	18.46

Note: In each case a loan for the number of months indicated at any point below the underscoring is usurious.

FOOTNOTES:

1. Technically, interest is the charge expressed as a percentage paid by the borrower, while yield is the rate of return to the lender. M. Ayres, Installment Mathematics Handbook 107 (1946).

2. M. Neifeld's Guide to Installment Computations 193 (1951); Thorndike, Encyclopedia of Banking and Financial Tables Sec. 16 (1973).

3. Id. at 195.

OPINION ON PETITION TO REHEAR

Cumberland Capital[1] has filed an elaborate petition to rehear taking exceptions to the holding of the Court and rearguing the issues. Additionally, it invokes the due process clause of the Fourteenth Amendment to the Constitution of the United States, as well as the "commerce clause" (article I, section 8, clause 3).

Petitioners, in their zeal, seemingly have overlooked that this matter came before us on interlocutory appeal. The jurisdiction of this Court was invoked under Sec. 27-305, T.C.A., upon the basis that it involved "a controlling question of law as to which there is substantial ground for difference of opinion." Two questions were certified, viz.:

> 1. Are the terms of Tennessee Code Annotated Section 45-2007 violative of Article XI, Section

7 of the Constitution of the State of Tennessee

2. [If so] is the original complainant entitled to a computation of interest at the rate prescribed by Article XI, Section 7 of the Constitution of the State of Tennessee?

We elect to take jurisdiction of the appeal and answered both jurisdictions fully and finally. Further comment upon the various ramifications of the opinion is improper and would be sheer dicta. It is unfortunate that the nature of the appeal and the established principles of appellate review have combined to produce a narrow consideration of limited issues resulting in many questions, the resolution of which is not before this Court. We cannot give advisory opinions.

Our resolution of the issues thus presented came as a result of painstaking

research, intensive study and intra-court conferences, during which all phases of the controversy were vigorously debated and discussed. The finished product represents the considered judgment of this Court. Further consideration would serve no useful purpose. We, therefore, overrule, without extended discussion, and as without merit, all questions presented except that relating to the single issue of retroactive versus prospective application.

The leading case on the subject of the prospective application of decisional law is Great Northern Ry. Co. v. Sunburst Oil & Ref. Co., 287 U.S. 358, 53 S. Ct. 145, 77 L.Ed. 360 (1932). Justice Cardozo's discussion of this issue has come to be known as the "Sunburst" doctrine or technique:

> A state in defining the limits of adherence to precedent may make a

> choice for itself between the principle of forward operation and that of relation backward. It may say that decisions of its highest court, though later overruled, are law none the less for intermediate transactions. Indeed there are cases intimating, too broadly (citations omitted) that it must give them that effect; but never has doubt been expressed that it may so treat them if it pleases, whenever injustice or hardship will thereby be averted. (Emphasis in original). 287 U.S. at 364, 53 S.Ct. at 148.

In Linkletter v. Walker, 381 U.S. 618, 85 S.Ct. 1731, 14 L.Ed.2d 601 (1965), the Court makes it clear that:

> . . . the accepted rule today is that in appropriate cases the Court may in the interest of justice make the rule prospective. 381 U.S. at 628, 85 S. Ct. at 1737.

We think it beyond doubt that this Court, acting in its judgment and discretion, and within the framework of established legal principles, may apply the holding of the

instant case either retroactively or prospectively.

Vigorously competing principles of law are involved. Petitioner urges a rule of complete prospective application based on the "presumption of validity" theory, while respondents urge the application of the "void ab initio" doctrine. A discussion of these legal principles is appropriate.

Under the "void ab initio" approach the statute is given no effect and treated as though it never existed, whereas under the "presumption of validity" approach, it must be presumed valid until invalidated by a court of competent jurisdiction. The progenitor of the "void ab initio" approach in American jurisprudence is Norton v. Shelby County, 188 U.S. 425, 442, 6 S. Ct. 1121,

1125, 30 L. Ed. 178 (1886), wherein the Court formulated the theory thusly:

> An unconstitutional act is not a law; it confers no rights; it imposes no duties; it affords no protection; it creates no office; it is, in legal contemplation, as inoperative as though it had never been passed.

The Supreme Court of the United States, however, has retreated, at least partially, from this broad formulation where necessary to achieve a more equitable or practical result.

It was first questioned in Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371, 374, 60 S. Ct. 317, 318-319, 84 L.Ed. 329 (1940), where the Court speaking through Chief Justice Hughes, said:

> [S]uch broad statements as to the effect of a determination of unconstitutionality must be taken with qualifications. The actual existence of a statute, prior to such a determination, is an oper-

> ative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to be considered in various aspects,--with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights, claimed to have become vested, of status, or prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination. These questions are among the most difficult of those which have engaged the attention of courts, state and federal, and its manifest from numerous decisions that an all-inclusive statement of a principle of absolute retroactive invalidity cannot be justified.

In Lemon v. Kurtzman, 411 U.S. 192, 93 S.Ct. 1463, 36 L.Ed. 2d 151 (1973), Norton came under further critical scrutiny. There Chief Justice Burger said:

> However appealing the logic of

> Norton may have been in the abstract, its abandonment reflected our recognition that statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity. (Emphasis supplied). 411 U.S. at 199, 93 S.Ct. at 1468.

Notwithstanding the seeming demise of Norton at the hands of its creator, it continues to have at least limited validity in Tennessee.

It was cited, and the pertinent language quoted, in Beaver v. Hall, 142 Tenn. 416, 217 S.W. 649 (1919); however, the Court declined to follow it.

In Roberts v. Roane County, 160 Tenn. 109, 23 S.W.2d 239 (1929), Norton was cited as "the general rule", but the court introduced an element of estoppel by adding

> But it is recognized that parties may so deal with each other upon the faith of such a statute that neither may invoke the aid of the courts to undo what they themselves have done. 160 Tenn. at 124, 23 S.W.2d at 243.

Norton was cited and followed in Henry County v. Standard Oil Co., 167 Tenn. 485, 71 S.W.2d 683 (1934).

It was again followed in State v. Hobbs, 194 Tenn. 323, 250 S.W.2d 549 (1952), and in O'Brien v. Rutherford County, 199 Tenn. 642, 288 S.W.2d 708 (1955).

In State v. Collins, 528 S.W.2d 814 (Tenn. 1975), we applied the rule to a case "wherein the question before the court was the appropriate statutory punishment for the criminal offense with which defendant was charged."

However, in Capri Adult Cinema v. State, 537 S.W.2d 896, 899 (Tenn. 1976), the

latest pronouncement of this Court, the Court, without citing Norton, but citing State v. Hobbs, supra, with its qualifying language, in effect declined to follow the Norton rule, holding instead:

> The principle is well settled in civil litigaton that when parties have dealt with each other at arms' length upon the basis of an unconstitutional statute, they are bound by the results of their actions.

The dissenting opinion [in] Capri cited the Norton rule as set forth in Henry County v. Standard Oil Co., supra; however, this reliance was in the context of a conviction under a criminal statute subsequently declared unconstitutional.

No reported Tennessee case has discussed the "void ab initio" approach in the context of the retroactive versus prospective application of a declaration of

the unconstitutionality of a statute. While Norton may have some continuing validity under some circumstances, we do not consider it authoritative or dispositive of the issues at hand.

We think the better, more equitable and more realistic rule is that "an unconstitutional act 'is not void, but voidable only,' until condemned by judicial pronouncement." Roberts v. Roane County, supra. As phrased in Bricker v. Sims, 195 Tenn. 361, 368, 259 S.W.2d 661, 664 (1953):

> Every act of the Legislature is presumptively constitutional until judicially declared otherwise. . ..

The decisional law of Tennessee has followed the "presumption of validity" rule in numerous reported cases.[3]

In the case of Perkins v. Eskridge, 278 Md. 619, 366 A.2d 21 (1976), the Maryland

Court of Appeals, in a most excellent opinion, focuses upon the issue thusly:

> . . . it seems clear that the modern trend has been away from the doctrinaire void ab initio approach toward the more realistic views which have applied tests of reasonableness and good faith to determine the consequences flowing from conduct undertaken pursuant to an unconstitutional act. 366 A.2d at 29-30.

Numerous reported cases deal with the issue of prospective application of decisional law declaring state statutes to be unconstitutional. See, e.g. Deltona Corporation v. Bailey, 336 So.2d 1163 (Fla.1976); Barnett v. Develle, 289 So.2d 129 (La.1974); Westbrook v. Mihaly, 2 Cal.3d 765, 87 Cal.Rptr. 839, 471 P.2d 487 (1970); and Austin v. Campbell, 91 Ariz. 195, 370 P.2d 769 (1963).

In the landmark case of Linkletter v.

Walker, 381 U.S. 618, 85 S.Ct. 1731, 14 L.Ed.2d 601 (1965) the Court established criteria for determining whether new constitutional rulings, in both civil and criminal cases, would be applied retrospectively or prospectively. The Court said:

> Once the premise is accepted that we are neither required to apply, nor prohibited from applying, a decision retrospectively, we must then weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. 381 U.S. at 729, 85 S.Ct. at 1738, 14 L.Ed.2d at 608.

Many considerations enter into a determination of whether to apply a decision of this nature retroactively. A foremost consideration must be fundamental fairness. The Court, in Cipriano v. City of Houma, 395

U.S. 701, 89 S.Ct. 1897, 23 L.Ed.2d 647 (1969), recognized this:

> [where] a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the "injustice or hardship" by a holding of nonretroactivity. 395 U.S. at 706, 89 S.Ct. at 1900, 23 L.Ed.2d at 652.

The Supreme Court in Chevron Oil Company v. Huson, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971), set forth standards or factors in cases dealing with retroactivity:

> First, the decision . . . must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly fore-shadowed. . . . Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we have

> weighed the inequity imposed by retroactive application." . . .. 404 U.S. at 106-107, 92 S.Ct. at 355, 30 L.Ed.2d at 306.

The Sixth Circuit, in Rivera v. Rose, 465 F.2d 727, 729 (1972), listed the criteria for determining prospective application as follows:

> . . . (1) the purpose to be served by the new standard (2) the extent of the reliance by law enforcement officials upon prior decisions on the subject, and (3) the effect on the administration of justice of a retroactive standard.

Finally, in Lemon v. Kurtzman, supra, the Court, in a matter of equitable cognizance, determining against retroactivity, saying:

> In equity, as nowhere else, courts eschew rigid absolutes and look to the practical realities and necessities inescapably involved in reconciling competing interests, notwithstanding that those interests have constitutional roots. 411 U.S. at 201,

93 S.Ct. at 1469, 36 L.Ed.2d at 162.

The most excellent case of United States v. Benitez Rexach, 411 F.Supp. 1288 (D.Puerto Rico 1976), relying upon Chevron, supra, adds the important factor of "foreseeability of the lack thereof, that the legal doctrine or statute in question would be declared unconstitutional."

Prompted by these authorities and motivated by our concept of fundamental fairness, we believe the controlling considerations in determining whether to apply a declaration of the unconstitutionality of a statute on a retrospective versus a prospective basis are these:

(1) The prior history of the rule in question, its purpose and effect. Linkletter, supra; Chevron, supra.

(2) Whether retrospective operation will further or retard its operation. Linkletter, supra; Chevron, supra; Rivera, supra.

(3) Whether retrospective operation would produce substantial inequitable results. Cipriano, supra.

(4) Whether litigants and others similarly situated have relied upon the unconstitutional statute. Chevron, supra; Rivera, supra.

(5) Whether the declaration of unconstitutionality was foreseeable. Chevron, supra.

(6) The effect on the administration of justice. Rivera, supra; Benitez Rexach, supra.

While strictly speaking, we have not declared any statute to be unconstitu-

tional,[4] we apply these criteria to the case at bar, and with specific reference to Industrial Loan and Thrift Companies.

The history of the constitutional and statutory provisions of Tennessee relating to interest are set forth in great detail in the main opinion. The purpose and effect of the qualified declaration of unconstitutionality was to bring the laws of Tennessee relating to interest rates charged by Industrial Loan and Thrift companies into harmony with the pertinent provisions of the Constitution of Tennessee. This purpose and effect will be accomplished irrespective of its application. In our view, general retroactive application will only serve as a penalty and will neither further nor retard the effective operation of the decision reached.

Wholly retrospective operation will

produce substantial inequitable results. Cumberland Capital asserts in its petition to rehear that "[m]illions of transactions involving billions of dollars have been undertaken in reliance on it." While we do not know the specifics, we are persuaded that the impact of general retroactive application would be enormous.

While we are only concerned in this action with the constitutionality of Sec. 45-2007(f) T.C.A., it is possible that the rationale of this opinion will apply to other statutes, however, they are not before the Court for consideration, and it would be improper for us to make an advance determination on financial institutions not parties to this controversy.

Industrial Loan and Thrift Companies have relied upon the constitutionality of

Sec. 45-2007(f) T.C.A.

Applying the decision on a wholly retroactive basis would not only result in financial disaster to the affected lending agencies that have loaned in the manner and at the rate authorized by the Industrial Loan and Thrift Act, but would clog the courts for years to come with untold lawsuits brought by those who would seek to avoid their solemn contractual commitments.

We apply the decision in this case to all notes, contracts, and obligations signed, or incurred, on and after August 23, 1977, and to all interest accruing on and after that date, irrespective of the date the instrument was signed, or the obligation was incurred. However, we apply it retroactively to all cases wherein there has not been strict compliance with the Industrial Loan

and Thrift Company Act as set forth in Section 45-2001 through Section 45-2021, T.C.A.; (Main volume and 1976 Supplement).

Consideration of fairness and public policy, along with the criteria herein discussed, command this conclusion.

As indicated in our main opinion, we apply the decision retroactively to the instant suit.

We fully realize that there are other litigants now in various stages of trial or appellate process who will be foreclosed by the rule of limited prospective application we have announced. This is an unavoidable consequence of the basic principle that this Court may not give advisory opinions. If we do not apply the rule we announce to the case at bar, everything we have said becomes advisory in nature and is pure dicta. If we do

not apply it to Industrial Loan and Thrift Companies that have not fully complied with statutory provisions, we would be legitimating unfair lending practices.

The Supreme Court of the United States faced this problem in Stovall v. Denno, 388 U.S. 293, 87 S.Ct. 1967, 18 L.Ed.2d 1199 (1967), and said:

> Inequity arguably results from according the benefit of a new rule to the parties in the case in which it is announced but not to other litigants similarly situated in the trial or appellate process who have raised the same issue. But we regard the fact that the parties involved are chance beneficiaries as an insignificant cost for adherence to sound principles of decision making. 388 U.S. at 301, 87 S.Ct. at 1972, 18 L.Ed.2d at 1206.

Further, and on somewhat less esoteric grounds, we find that "the party who brings about the change in law may not pro-

perly be deprived of the fruits of his victory". Schaefer, "The Control of 'Sunbursts': Techniques of Prospective Overruling," 42 N.Y.U.L.Rev. 631 (1967), reprinted in R. Leflar, Appellate Judicial Opinions, at 141 (1974).

And as the California Supreme Court said in Li v. Yellow Cab Co., 13 Cal.3d 804, 119 Cal.Rptr. 858, 876, 532 P.2d 1226, 1244 (1975):

> [T]he new rule here announced should be applied additionally to the case at bench so as to provide incentive in future cases for parties who may have occasion to raise "issues involving renovation of unsound or outmoded legal doctrines."

Hence, we apply the new rule to the case at bar, but prospectively to all present or future litigants, except in those cases

where the lender did not comply with the Industrial Loan and Thrift Act.

COOPER, C. J., and FONES, J., concur.

HARBISON, J., dissenting in part, concurring in part.

HARBISON, Judge, concurring in part, dissenting in part.

I concur in the majority opinion overruling the petition for rehearing, except that portion dealing with the prospective operation of the decision of the Court.

As pointed out in the majority opinion, this case was before the Court on a limited, expedited interlocutory appeal, in which only two questions had been certified by the trial judge. This was emphasized in the principal brief filed on behalf of the lending agencies, in which it was stated that the case was in this Court "for consideration

solely of the two questions he certified . . .." Again, in their brief, appellants stated:

> "The general, abstract, constitutional question is the sole determinative issue in this case, and it will be so treated here."

In my opinion the Court answered the two certified questions fully and completely in its principal opinion and remanded the case to the trial court for futher testimony and for final decision. As was pointed out in the case of Tennessee Department of Mental Health v. Hughes, 531 S.W.2d 299, 300 (Tenn.1975), in dealing with interlocutory appeals the Court requires the exact and precise questions to be reviewed to be stated in the order granting the appeal, and limits its decision to those specific questions. For this reason, it seems inappropriate to me to attempt to deal with the ramifications of the

decision or with any other questions pertaining to it, in light of the incomplete and undeveloped record which is before the Court.

Further, I do not consider that the decision in the principal opinion was a material or major departure from prior decisional law in this State. On the contrary, it seems to me to be entirely consistent with the previous cases. In Pugh v. Hermitage Loan Company, 167 Tenn. 389, 393, 70 S.W.2d 22, 23 (1934), the Court said:

> "A statute permitting a lender to charge sums as compensation for the use of money which amount to more than at the rate of ten per cent per annum is in clear conflict with the Constitution, whether the charge be denominated in the statute interest or fees or by any other name."

For these reasons, at this time and on the present record, I am unable to concur in so much of the Opinion on Petition to Rehear

as deals with the issue of prospective application of the decision. Interlocutory appeals, no doubt, serve a useful purpose, but parties utilizing this special appellate procedure, occurring, as it were, in the midst of the handling of the case in the trial court, should not expect the Court to respond to any issues except those certified here.

I am authorized to state that Mr. Justice BROCK concurs in this Opinion.

FOOTNOTES:

1. An Indiana corporation, erroneously identified in our opinion as a Tennessee corporation.

2. No issue was presented under the Federal Constitution.

3. Collier v. Montgomery County, 103 Tenn. 705, 54 S.W. 989 (1900) (a contract made between county and sheriff under a law later declared unconstitutional held binding upon the parties and sheriff not permitted to

disaffirm and collect greater amount); Beaver v. Hall, 142 Tenn. 416, 217 S.W. 649 (1919) (an unconstitutionally created court was a de facto court until there was a judicial determination of its invalidity); Roberts v. Roane County, 160 Tenn. 109, 23 S.W.2d 239 (1929) (county estopped from recovering money paid to sheriff under a void statute); Claybrook v. State, 164 Tenn. 440, 51 S.W.2d 499 (1932) (criminal liability may not be predicated upon conduct lawful under a statute subsequently declared unconstitutional); Rust, et al. v. Newby, 171 Tenn. 127, 100 S.W.2d 989 (1937) (The presumption in favor of the validity of statutes requires that they be observed until declared void by an authoritative tribunal); State v. Hobbs, 194 Tenn. 323, 250 S.W.2d 549 (1952) (county not permitted to recover salary paid under a constitutional act).

4. The main opinion holds that "Sec. 45-2007(f) is unconstitutional and void, insofar as it is applied to any note or obligation, discounted at 7½% per annum and payable in monthly installments, or to any other transaction, regardless of how payment is programmed, if the end result is an effective rate of interest in excess of ten percent."

UNITED STATES DISTRICT COURT
W.D. TENNESSEE, W.D.

In Re O. C. BOGAN, Debtor.

February 28, 1968

OPINION

ROBERT M. McRAE, Jr., District Judge.

This is a petition to review the actions of the Referee in Bankruptcy in a Chapter XIII, Wage Earner Plan Proceeding. The review was sought by Memphis Loan & Thrift Company, Inc., hereinafter called Loan Company. The primary issue concerns whether or not an unsecured note which was the basis of the claim of the Loan Company is usurious under the law of Tennessee.

On June 1, 1967, the debtor, O.C. Bogan, filed a Wage Earner's Petition in the

Bankruptcy Court. A meeting of creditors and adjournments thereof were held to consider the Plan. The Loan Company first unsuccessfully undertook to become a secured creditor. On June 27 or June 28, 1967, the Loan Company indicated that it was an unsecured creditor and filed a claim rejecting the proposed plan. On June 28, 1967, the Referee entered an order requiring the Loan Company to appear July 7 and produce specific information concerning possible usurious features of the claim. On July 7, 1967, the Loan Company was granted additional time to comply with the Referee's order of June 28, 1967, and the Referee questioned the attorney for the Loan Company concerning possible usurious features of the claim and others filed by the Loan Company in other cases. On July 19, 1967, the Referee filed a Memorandum Opinon

and Order requiring the Loan Company to present to the Court on July 21, 1967, the date of the last scheduled adjourned meeting of creditors, certain documents and evidence to prove the claim it had filed under the Wage Earner Plan. The Memorandum Opinion and Order was 25 pages in length and set forth in detail the reasoning and conclusion of the Referee pertaining to the law of usury as applicable to the Loan Company which operated under the Industrial Loan and Thrift Act of the State of Tennessee. The opinion dealt with the claim in the instant case and specific claims of a similar nature in other Wage Earner cases wherein this loan company had filed claims in pending Wage Earner Plans in the Bankruptcy Court. The Memorandum Opinion and order also ordered the attorney for the Loan Company to file affidavits at a later

date, pertaining to possible usurious features as set forth in the opinion of the Referee in all claims filed by the Loan Company since June 1, 1966. It was estimated that this involved approximately 225 cases.

On July 21, 1967, the Adjourned Meeting of Creditors was had and an amended order approving the plan was entered on that date. The order indicated that the proposed plan was approved and that the Loan Company "had agreed" to file a claim and would receive $17.00 in monthly payments as an unsecured creditor. Subsequent thereto, on July 24, 1967, the Loan Company filed an amended claim accepting the plan but it did not comply with the Referee's orders of June 28, 1967 and July 19, 1967.

There was attached to the amended claim a printed form of promissory note

signed by the debtor in the amount of $612.00, payable in eighteen monthly installments of $34.00 each, including the final installment. The note dated March 10, 1967, hereinafter will be referred to as the "claim note". It was signed as the fifth in a series of notes made by the debtor in favor of the Loan Company which series began January 8, 1966, when the debtor executed a note for $150.00. The successive notes dated April 30, 1966, August 5, 1966, December 1, 1966 and the claim note, dated March 10, 1967, all constituted a new loan made before the preceding loan had been repaid and included the amount necessary to pay the balance of the preceding loan.

The claim note, on its face, bears a computation which reads as follows:

Date 3/10/67 Statement

Amount of Note		$612.00
Interest	55.08	
Loan Fee	24.48	
Ins: L 18.36 A&H 45.90	64.26	
Ins. Prop. 18.36	18.36	
Unpaid bal. former loan	450.00	
Total disbursed (subtract)		$612.18
Cash received by borrower	Minus	.18
Ref. Ins. L 12.47 A&H 24.71		37.18
Ref. Ins. Prop. 12.47		12.47
Refund-Interest		9.54
Cash to Cust		59.01

The items which were the basis of a refund had been charged in the prior note dated December 1, 1966, three months and ten days before the claim note. The charges on that prior note which formed the basis of the refund on the claim note are as follows:

	CHARGE	REFUND
Life, Acc't & Health Ins.	56.70	37.18
Property Insurance	16.70	12.47
Interest	48.60	9.54

The claim was filed on a printed form that provides spaces for the insertion of the names of the debtor and creditor, the number of the cause, and the amount of the claim. The claim was signed "Memphis Loan & Thrift, by Charles A. Walt." Charles A. Walt was an officer in the company as required by Gen. Order 21, 11 U.S.C. following § 53. The claim does not contain any specific information concerning usury. It merely recites, "Memphis Loan & Thrift, 25 S. Second Street, Memphis, Shelby County, Tennessee, being duly sworn, deposes and says:

> " * * * * * * *
> 7. That the claim is free from usury."

After the petition to review was

filed, there was also filed in the cause an affidavit made by the Vice President of the Loan Company which recited that the claim, in the amount of $581.40, based on a promissory note executed by O.C. Bogan, is free from usury as defined by the laws of the State of Tennessee.

In its petition for review, the Loan Company prayed that the Memorandum Opinion of the Referee be reviewed and held for naught; that the Court adjudge that the Referee issue no further orders in regard to the claim of the Loan Company in the instant case or to its claims in other causes in which the plans had been confirmed by the Referee. The petition further prayed that if the Court be of the opinion that it should decide whether or not the claim in the instant case was usurious, that petitioner be allowed to

introduce additional proof in many categories.

At the hearing on the petition to review, this Court ruled that under the facts of the case, including irregularities in the signing of the claim, the Referee had the power to make further inquiry into the question of usury even though an amended order had been entered conditionally approving the plan. The order approving the amended plan was entered before the claim of the Loan Company was filed and the Court so finds. The Court further ruled that Memorandum Opinion and Order of the Referee entered in this cause could not and did not affect other pending causes in the Bankruptcy Court. Wherefore, petitioner was sustained to that extent. At that time the Court referred the matter to the Referee for further hearings

and proof concerning usury of the claim of the Loan Company in the instant case.

The Referee scheduled hearings. Immediately prior thereto, the Loan Company sought permission of the Referee to withdraw its claim with prejudice. The Referee overruled that application and the Loan Company then amended its claim to "zero", and moved that the hearings not be conducted. Similar motions were made ex parte to this Court and overruled, and the hearings were conducted by the Referee. Findings of Fact and Conclusions of Law were filed by the Referee wherein he determined that the claim note was usurious on its face in that it provided for illegal interest under the Tennessees law and, further, in that the loan or investigation fee provided for in the Industrial Loan and Thrift Act at the rate of

$4.00 per $100.00 of the principal amount of the loan exceeded the allowable amount and that the excess constituted usurious computation of interest. The Referee further found that the facts did not support a loan fee of $4.00 per $100.00 for services and expenses as allowed in the Act.

The Referee further held that the claim note was usurious because the facts indicated that the debtor was charged with insurance without his request and that the Loan Company received substantial profits from the insurance premiums.

A subsequent hearing was conducted in this Court on oral argument and briefs. The petitioner now contends:

1. Under 11 U.S.C. § 1056(b) the Referee had no right or jurisdiction to inquire into the issue of usury after con-

firming the plan, in the absence of objections to the claim by the debtor, the trustee, or another creditor.

2. That the action of the petitioner in withdrawing its claim and reducing it to zero rendered further proceedings in the cause moot, wherefore the petition for review should be dismissed.

3. If contentions one and two should be denied, the Court should make its own findings because the report of the Referee is advisory only. The petitioner charges that the Referee prejudged the issues. Petitioner makes accusations that the Referee had a personal antagonism for the original lawyer of the Loan Company and that the Referee made harassing requirements of this loan company while disregarding the activities of other

loan companies similarly operating under the Industrial Loan and Thrift Act.

4. The Loan Company further contends that there is no usury in any event.

The Loan Company contends that the Referee was precluded from requiring further proof of the claim because he had approved the plan on July 21, 1967. The Loan Company relies upon 11 U.S.C. § 1056(b) which is Section 656(b) of the Bankruptcy Act and which provides as follows:

> "Before confirming any such plan the court shall require proof from each creditor filing a claim that such claim is free from usury as defined by the laws of the place where the debt was contracted."

Under the facts of this case the Referee had a right and duty to require further proof concerning the issue of usury in the claim of the Loan Company.

The plan was approved subject to certain creditors filing claims later. The Referee indicated prior to the filing of the amended claim his opinion on the law of usury in Tennessee. The claim ultimately filed ignored two orders of the Referee. The original attorney for the Loan Company was not the proper person to sign the claim and admitted that he was not familiar with the facts required by the Referee to determine the issue of usury. Futhermore, as will be indicated hereinafter, the claim note is usurious on its face.

In addition to the above reasoning, 11 U.S.C. § 93(k) provides:

> "Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, but not after the estate has been closed."

A Bankruptcy Court has equity power among which are the rejection in whole or in part, according to the equities of the case, of claims previously allowed. Pepper v. Litton, 308 U.S. 295, 304, 60 S.Ct. 238, 84 L.Ed. 281.

The referee upon his own motion and without objection by anyone may reconsider the allowance or status of a claim. American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A[.], 280 F.2d 119 (C.A.2, 1960).

The attempted withdrawal of the claim did not render the proceedings moot. Upon application and request of the Loan Company, further proceedings were granted by this Court and the Referee was directed to conduct hearings. It was the duty of the Referee to conduct the hearings and report to this Court.

Upon consideration of the entire record, the Court finds that the determination of the Referee herein was not motivated by any bias and did not reflect any inpropriety on his part. Statements in the briefs and argument of the petitioner have addressed themselves to erroneous and unfounded accusations against the Referee. This opinion will reflect the Findings and Conclusion of this Court, including any wherein the Court differs with the Referee on matters of fact in the record and the conclusions of law to be derived therefrom.

In Jenkins v. Dugger, 96 F.2d 727, 729, 119 A.L.R. 1484 the Court of Appeals for the Sixth Circuit considered usury under the Tennessee law and stated as follows:

> "Usury imports the existence of four elements: (1) A loan or forebearance, either express or

implied; (2) an understanding between the parties that the principal shall be repayable absolutely; (3) the exaction of a greater profit than allowed by law; and (4) an intention to violate the law.

The last may be implied if the first three are present. The element that a greater profit is exacted by the lender than allowed under the law must be made to clearly appeal in applying the statute here under consideration. It is not to be lightly assumed that the avarice of a lender would drive him to the risk of a forfeiture of his entire investment in order to obtain a slight unlawful gain.

A contract is usurious when there is any contingency by which the lender may get more than the lawful rate of interest. It does not depend on whether the lender actually gets more than is lawful, but whether there was a purpose to obtain more than legal interest for the use of his money, and whether the terms of the transaction and the means used to effect the loan are appropriate to that end.

In order to determine the illegality of the exaction the

inquiry must always be directed to what the lender is to receive, not what the borrower is to pay.

From the Mosaic laws to the present, every civilized society has recognized that the necessitous borrower was likely to become the victim of the avaricious lender, and the weight of every law on the subject has fallen on the possibility of the receipt by the lender of more that the law allowed and whatever the borrower might be required to pay to another in connection with the loan was not banned unless the lender by agreement, trick, or device could obtain an illegal exaction."

INTEREST

The claim note shows its amount to be $612.00, and on the face thereof it shows that $55.08 of the amount of the note is designated as interest. The note is payable in eighteen (18) installments of $34.00 each.

Interest is defined by statute in Tennessee as follows:

"Interest is the compensation

> which may be demanded by the lender from the borrower, * * * for the use of money." T.C.A. § 47-14-103.

It is the general rule in Tennessee that installment payments for an obligation are first applied to the interest and then to the principal. While the general rule may be varied by contract, a contract cannot control the computation of interest or the time interest should run so as to increase the rate of interest beyond the legal maximum. Dowler, Trustee v. Georgia Enterprises, Inc., 162 Tenn. 59, 34 S.W.2d 445.

In the instant case, interest was deducted in advance, pursuant to the Industrial Loan and Thrift Act, T.C.A § 45-2007, which provides, among the powers and privileges given to companies operating under the Act as follows:

"(f) To lend money on the per-

> sonal undertaking of a borrower or other persons, with or without security including certificates of indebtedness or investment purchased by the borrower simultaneously with said loan transaction, or otherwise, and to deduct interest in advance on the face amount of the loan for the full term thereof."

If it is assumed that all other charges set forth on the note are free from usury, the debtor received the use of $556.92 ($612.00, the amount of the note, less $55.08, the amount of the interest). In an installment transaction part of each payment represents the return by the borrower of part of the money which the lender has previously delivered to the borrower to use. Applying the general rule to the instant case, at the end of the first month the debtor was to pay $34.00, of which $2.78 was interest and $31.22 of the principal was returned. At the end of the payments the

debtor would have paid a total of $612.00, including interest at approximately 12% per annum on the use of $556.92.

Article 11, Section 7 of the Constitution of Tennessee provides as follows:

> "The Legislature shall fix the rate of interest, and the rate so established shall be equal and uniform throughout the State; but the Legislature may provide for a conventional rate of interest, not to exceed ten per centum per annum."

Conventional interest is contractual interest between the parties. Caruthers v. Andrews, 42 Tenn. 378.

In Pugh v. Hermitage Loan Co., 167 Tenn. 389, 70 S.W.2d 22, the Supreme Court of Tennessee referred to its former construction of the Small Loan Statute as follows:

> "We endeavored to give to the statute a construction which would not render it in conflict

> with the provisions of the Constitution of Tennessee, article 11, § 7, authorizing the Legislature to provide a conventional rate of interest 'not to exceed ten per centum per annum.' By this constitutional limitation the Legislature, as well as the 'freedom of contract' claimed by defendant, is limited in this jurisdiction."

Under the Industrial Loan and Thrift Act interest can be deducted in advance without violating the ten percent maximum interest rate allowed by the Constitution, but in the instant case the instrument shows on its face that the rate of interest is approximately twelve percent per annum.

Counsel for the Loan Company argue that the instrument signed by the debtor in the instant case was an investment certificate which was collateral security for the note and it is the certificate which is payable in installments instead of the note.

The facts do not support a finding that a separate investment certificate was security for the note. Furthermore, the claim was filed as an unsecured obligation.

It should be noted that this Court does not consider that it was called upon to determine the constitutionality of the Industrial Loan and Thrift Act; nor does it intend to hold that any portion thereof is violative of the Constitution of the State of Tennessee. The Court, therefore, finds in the instant case that the claim note was usurious on its face because it shows that the interest provided was in excess of the constitutional maximum.

The deduction of interest in advance and the practice of frequent renewals of the loans followed by the Loan Company shows a shocking opportunity for profit on the part

of the Loan Company. On March 10, 1967, the debtor signed a claim note, a portion of which was used to repay the balance on his December 1, 1966 obligation, which was itself the third renewal in a series. The December 1, 1966 obligation, which was [the] original amount of $540.00. On March 10, 1967, after the debtor had made three payments of $30.00 each, the balance due was $450.00. At the time that the December 1, 1966 loan was made the debtor was charged $48.60 interest, or six percent (6%) of $540.00 for fifteen months, and obligated himself to repay that in monthly installments. On March 10, 1967, the debtor was refunded $9.54 of the $48.60 which he was charged on December 1, 1966. The difference of $39.06 was in the $450.00 which was repaid, and he was charged an additional $55.08 for interest at the time of the

March 10th transaction. While it is true that the debtor is not required to make new loans, in doing so he signed notes which obligated him to pay $39.06 in interest for the use of the $90.00 which he had repaid over a period of three months. If the March loan had been paid as scheduled in this transaction, the Loan Company would have received a return on its $90.00 at a rate in excess of one hundred and fifty percent (150%) per annum. However, this problem appears to be one for the legislature or regulatory state agencies. The collection of interest in advance in the amount of the maximum allowed by statute is not usurious. Roller et al. v. Hamilton et al., 13 Tenn. App. 241. This does not mean that the constitutional maximum might be exceeded by collection of interest in advance.

Nor is it usurious to incorporate interest from a prior loan into the principal of a new loan by ageement [sic]. Parham v. Pulliam, Executor, 45 Tenn. 497.

Furthermore, the payment of a note before maturity does not entitle the debtor to demand the return of prepaid interest or interest accruing between the date of payment and maturity in the absence of an agreement thereto. Crowley v. Kolsky, 57 S.W. 386 (Tenn.Chan.App. 1900).

The Courts in Tennessee have also determined that a lendor or creditor may require a premium or bonus as a prepayment privilege charge when the prepayment is made voluntarily by the debtor. Silver Homes, Inc. v. Marx & Bensdorf, Inc., 206 Tenn. 361, 333 S.W.2d 810.

Therefore, in the absence of some

coercion, duress or misrepresentation by the loan company this exorbitant windfall on renewal is not in and of itself usury.

INVESTIGATION OR LOAN FEE

The Industrial Loan and Thrift Act, T.C.A. § 45-2007(i) allows companies qualified by the terms thereof:

> "To charge for services rendered and expenses incurred in connection with investigating the moral and financial standing of the applicant, security for the loan, investigation of titles and other expenses incurred in connection with the closing of any loan an amount not to exceed four dollars ($4.00) per each one hundred dollars ($100.00) of the principal amount loaned, and a proportionate amount for any greater or lesser amount loaned, provided no charge shall be collected unless a loan shall have been made."

The claim note indicates on its face that the loan fee was in the amount of $24.28, which is $4.00 per $100.00 on the face amount of

the note which was $612.00. Apparently some factor in excess of 4% is applied to the other items which are included in the note to arrive at $4.00 per $100.00 of the face amount of the note. It is undoubtedly true that an applicant for a loan would hardly be prepared to pay a loan or investigation fee in cash at the time the loan is applied for. Therefore, the Court is of the opinion that the Legislature intended to authorize that the proper loan fee could be borrowed in order to complete the transaction, but the Legislature did not intend for the fee to be charged on the fee itself. The Court is of the opinion that the principal amount of the note must be computed before the $4.00 per $100.00 is applied to compute the loan fee. In the instant case this was not done and the Loan Company has shown on the face of the

instrument to have received a slight profit in excess of $4.00 per $100.00, which constitutes excessive compensation and, therefore, usury.

This Court further finds that the proof in the instant case supports a finding that the loan fee was usurious in that it did not bear a reasonable relation to the expenses and services of the lender. The record reflects a series of five loans by the debtor from the Loan Company. The first of these five was executed on January 8, 1966, and was a loan in the face amount of $150.00, which included $6.00 investigation and loan fee. On April 30, 1966, less than four months after the first loan was made, a second loan was made in the amount of $270.00 which included an investigation fee of $10.80. On August 5, 1966, again less than four months,

a third loan was made in the total amount of $396.00, and an investigation and loan fee of $15.84 was charged. On December 1, 1966, less than five months, the third loan was repaid and a new loan was executed in the amount of $540.00, which included $21.60 investigation fee. On March 10, 1967, the claim note was executed in the amount of $612.00, and included a $24.48 investigation or loan fee. On the occasion of the execution of each note no portion of the former investigation or loan fee was refunded. The record reflects proof concerning the services of the Loan Company which justified the maximum charge in connection with the first loan. The time intervals and the successive charges for the investigation or loan fee in the maximum amount of $4.00 per $100.00 on the next four loans establishes a prima facie

case that the services rendered and expenses incurred by the Loan Company were excessive. The proof in the record by the Loan Company does not overcome the prima facie case. The Supreme Court of Tennessee in Koen v. State, 162 Tenn. 573, at page 581, 39 S.W.2d 283, held, when considering a Small Loan Act, that the Legislature could not authorize a lender to arbitrarily fix a maximum expense fee in addition to the interest on loans. In other cases the Supreme Court of Tennessee has held that "the transactions of small loan companies are open to inquiry for the purpose of determining whether or not the fees charged by the lender bear a reasonable relation to the service rendered or whether a charge was arbitrarily made with a view of evading the laws against usury." Family Loan Company of Nashville v. Hickerson, 168 Tenn. 36, 73

S.W.2d 694, 94 A.L.R. 664, and Personal Finance Co. v. Hammack, 163 Tenn. 641, 645, 45 S.W.2d 528. Therefore, under the facts of this case the Court finds that the loan and investigation fee was partially usurious on its face and otherwise usurious because the record establishes that it was not for expenses or services rendered.

INSURANCE

The Industrial Loan and Thrift Act provisions on insurance are set forth in T.C.A. § 45-2007(k), which allows lenders:

> "To require at the expense of the borrower, insurance against the hazards to which the collateral used to secure the loan is subject, and upon failure of the borrower to supply such insurance, to procure the same and to accept, but not require, as collateral, insurance against the hazards of death or disability of a borrower; provided, however, that such insurance shall be obtained from a licensed

> agent and issued by an insurance company authorized to conduct such business in the state of Tennessee at rates approved by the department of insurance and banking of the state of Tennessee, and provided that the amount of the loan and the type of coverage bears a reasonable relation to the existing hazard or risk of loss."

This section requires a determination of facts to resolve whether or not the Loan Company in the instant case was in compliance therewith. The Court finds that an official of the Loan Company was also an agent of the insurance companies which wrote the insurance provided for in the loan note. Contracts with the insurance companies allowed the agent fifty percent (50%) of the premium as commission with a proviso that refunds of premiums to the policy holder (the borrower) would, in turn, be refunded to the company. Therefore, the net commissions of the agent

of the company were less than fifty percent (50%) of the total premiums charged. However, there was an obvious substantial profit to the Loan Company on these insurance transactions. This debtor was able to write little more than his signature and was unable to read the documents presented to him at the hearing. His testimony refutes the Insurance Application and Authorization Form which he signed at the time that he secured the loan. The debtor testified that he did not request credit life and accident and health insurance; that no official of the Loan Company made clear the conditions with respect to the insurance protection; and that he was not given an opportunity to obtain Fire Insurance with the agent of his choice.

The portion of the Industrial Loan and Thrift Act which allows a company to require

hazard insurance to protect collateral is inapplicable to the case because the claim is an unsecured obligation. The Court finds that the Loan Company required all insurance provided for in the claim note.

This Court agrees with the opinion of Judge Parrott of the Tennessee Court of Appeals, expressed in Hagler v. American Road Insurance Co. and Ford Motor Credit Co., (unreported) wherein the Court affirmed the Chancellor who had disallowed insurance required by a Credit Company official while playing a dual role of an insurance company agent. Judge Parrott's opinion provides as follows:

> "In our opinion, to permit such a dual agency on the part of these defendants creates a bad situation. If such is not a violation of the law it is a practice which could lead only to trouble and misunderstandings and presents a breeding ground for fraud."

On the facts of the instant case the Court is of the opinion that the insurance charged the debtor by the Loan Company was required of the debtor to obtain the loan. Therefore, the Loan Company acquired additional profit for the use of lending its money which constituted usury.

CONCLUSION

It is the conclusion of this Court that the Referee in Bankruptcy had the power and duty to require of the Loan Company further proof concerning possible usurious phases of its claim note.

The Court is further of the opinion that the claim note was usurious on its face in that it provided for interest in excess of the amount authorized by the Legislature of Tennessee and that a portion of the loan or investigation fee charged was in excess of

the amount allowable by the Industrial Loan and Thrift Act because it was partially in excess of the "principal amount" of the loan.

The Court is further of the opinion that the claim note was also usurious in that the remainder of the investigation or loan fee on the claim note was not a charge for services rendered and expenses incurred in the investigation of the debtor and that the insurance premiums included usurious profit because the insurance was required to be purchased to procure the loan as prohibited by the Industrial Loan and Thrift Act.

The Court is further of the opinion that the Loan Company did not have the right to withdraw its claim without prior approval of the Court under the facts of this case. The Loan Company does have the right to acknowledge that there is nothing due.

Because the Loan Company did so acknowledge, the Trustee is authorized and directed to reflect that the claim of the Loan Company is satisfied by its own admission and the plan should be administered for the benefit of the other creditors who have filed proper claims.